Second Circuit Decision Improves PBGC’s Position in Chapter 11

On April 8, the Second Circuit Court of Appeals reversed the Bankruptcy Court and concluded that special ERISA “termination premiums” due PBGC are not contingent prepetition claims subject to discharge in a chapter 11 reorganization. Pension Benefit Guar. Corp. v. Oneida, Ltd., 2009 WL 929528 (2d Cir. April 8, 2009), rev’g Oneida Ltd. v. Pension Benefit Guar. Corp., 383 B.R. 29 (Bankr. S.D.N.Y., 2008).

The case addressed ERISA Section 4006(a)(7), added by the Deficit Reduction Act of 2005 (the “DRA”), which generally requires an employer to pay the Pension Benefit Guaranty Corporation (“PBGC”) a “termination premium” following termination of an underfunded U.S. tax-qualified pension plan sponsored by the employer. For large plans, the termination premium can be substantial: the premium is paid for three years, at the rate of $1,250 per year per participant, based on participant headcount on the plan termination date. In the case of a chapter 11 reorganization, the premium is payable following emergence. The Bankruptcy Court had ruled that liability for the termination premiums represented a contingent prepetition claim under section 101(5) of the Bankruptcy Code and could be discharged as part of a chapter 11 plan. The Second Circuit rejected that analysis.

PBGC Recoveries Enhanced

In the typical chapter 11 case, PBGC’s claims for pension underfunding are generally treated as dischargeable unsecured prepetition claims. PBGC is sometimes able to improve its recovery relative to other unsecured creditors owing to PBGC’s statutory ability to assert its underfunding claims against “controlled group” affiliates of the bankrupt entity — including, according to PBGC, foreign affiliates. (In the typical case, the “controlled group” consists of an ultimate parent business and its 80%-owned subsidiaries.) The Oneida decision raises the stakes for creditors competing with PBGC and enhances the likelihood of a PBGC recovery superior to other general unsecured creditors. At the least, the decision will complicate the process of negotiating settlements in chapter 11 cases among PBGC and other creditors. Because the termination premium does not necessarily arise in a chapter 7 liquidation, debtors may show greater interest in business restructurings that include liquidation.

The Special Termination Premium

The DRA added section 4006(a)(7) to ERISA, which imposes a special premium payable to PBGC following termination of a U.S. tax-qualified pension plan in certain “distress” or “involuntary” termination proceedings. The termination premium is additional to PBGC’s regular...
claim for 100% of the termination date underfunding. As with PBGC’s claim for termination date underfunding, the liability for the termination premium is shared jointly and severally among the employer-sponsor and its controlled group members. The termination premium statute was initially set to sunset for plans terminated after 2010, but was made permanent by the Pension Protection Act of 2006.

The termination premium applies to involuntary plan terminations initiated by PBGC. The termination premium also applies to certain “distress” plan terminations initiated by the employer -- namely, plan terminations in chapter 11 cases (or in similar state law proceedings) and plan terminations needed to enable the employer-sponsor to continue in business outside bankruptcy proceedings.

The termination premium does not apply to plan terminations initiated by the employer in a liquidation proceeding under chapter 7 of the Bankruptcy Code (or in similar state law proceedings). The scope of this liquidation exception is not completely clear. Moreover, according to the PBGC’s regulations, even if the employer-sponsor is liquidating, the termination premium will apply if at least one controlled group member is not doing so.

The termination premium is payable for three years, generally starting upon plan termination. However, if the plan is terminated while the employer is in chapter 11 reorganization, payments are to start when the employer is discharged or the case dismissed.

The Oneida Case

Oneida Ltd. commenced a chapter 11 case in 2006, shortly after passage of the DRA. After initially seeking to terminate three of its defined benefit pension plans, Oneida and PBGC reached a settlement to terminate the most severely underfunded plan, with each party reserving its rights with respect to the termination premium. Following Oneida’s emergence from chapter 11 in September 2006, PBGC demanded termination premiums of approximately $7 million. Oneida sought a declaratory judgment in the Bankruptcy Court, asserting that the premiums were “claims” under section 101(5) of the Bankruptcy Code, arising prepetition and were therefore discharged by Oneida’s reorganization plan.

In deciding that the termination premiums indeed represented a contingent prepetition “claim,” the Bankruptcy Court held that the Bankruptcy Code should control questions of what obligations are “claims” and when such claims arise, and noted that the Bankruptcy Code could not be impliedly amended by another federal statute (such as ERISA). The Court also noted that the term “claims” under the Bankruptcy Code means “all legal obligations of the debtor, no matter how remote or contingent” and rejected PBGC’s contention that the premiums could not be a “claim” because they were not due until after the conclusion of the reorganization proceedings. The Bankruptcy Court went on to reject PBGC’s assertion that if the premium obligation were a “claim,” it would represent a post-petition claim entitled to priority as an administrative expense. The Court noted that under the Bankruptcy Code, a claim created by statute “dates from the time of commencement of the relationship between the parties and not when the right to payment becomes enforceable” and went on to find that the critical factor in determining when a contingent obligation arises is whether the parties “contemplated the obligation” at the time of filing the chapter 11 petition. Noting that the DRA was enacted prior to Oneida’s chapter 11 filing and citing the prepetition negotiations between Oneida and PBGC, the Bankruptcy Court concluded that the termination premium claim arose prepetition. Moreover, the Bankruptcy Court concluded that the enactment of the DRA statute did not
manifest the requisite showing of Congressional intent to make the termination premiums nondischargeable in reorganization cases -- that is, the Court felt that there was no clear Congressional intention that the DRA should be interpreted as modifying the Bankruptcy Code.

On appeal, the Second Circuit Court of Appeals reversed and remanded. Although the Second Circuit agreed that “claim” should be interpreted broadly under the Bankruptcy Code, the Court noted that “the definition’s reach is not infinite.” Moreover, the Second Circuit looked to ERISA (and the legislative history of the DRA), not the Bankruptcy Code, for determining when the termination premium claim arises. In so doing, the Second Circuit found that the special rule for delayed payment of termination premiums reflected the statute’s “obvious purpose” to prevent employers from evading termination premiums during reorganization proceedings. Oneida had argued that to enforce the DRA premium in this way would be tantamount to an implied amendment of the Bankruptcy Code. The Second Circuit, however, interpreted this as Congress’s right to determine “when a claim will be legally effective for purposes of the Bankruptcy Code.” The Court concluded that the DRA provisions of ERISA are unambiguous as to when the termination premium claim arises -- only upon conclusion of the chapter 11 case -- and thus held that the PBGC’s termination premium claim is not a prepetition claim subject to discharge in chapter 11.

Conclusion

The Oneida case is the first reported case to interpret the PBGC termination premium statute. It is possible that courts in other Circuits might reject the Second Circuit’s ruling and follow the reasoning of the Oneida Bankruptcy Court. However, for the time being, companies in all jurisdictions will probably plan for reorganization on the assumption that PBGC’s termination premium claim is a non-dischargeable cost of terminating a pension plan in chapter 11. While there may be ways to structure around this cost -- perhaps using a liquidating chapter 7 case, for example -- this ruling gives PBGC extra leverage in dealing with (or avoiding) pension plan termination in ordinary chapter 11 cases.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. If you have questions about this memorandum or about PBGC and other ERISA claims in bankruptcy, please contact Robert C. Fleder at (212) 373-3107, Alan W. Kornberg at (212) 373-3209, Jeffrey D. Saferstein at (212) 373-3347, Lawrence Wildorochic at (212) 373-3237 or Maureen A. Riley at (212) 373-3265.