AMERICAN BANKRUPTCY INSTITUTE
JOURNAL

June 2009 • Issues and Information for Today's Busy Insolvency Professional • Vol. XXVIII, No. 5

Second Circuit Holds that Premiums Payable to PBGC after Termination Not Dischargeable

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About the Author

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In an important decision published recently, *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, 2009 WL 929528 (2d Cir. April 8, 2009), the Second Circuit Court of Appeals reversed a decision by the U.S. Bankruptcy Court for the Southern District of New York, which held that "termination premiums" payable to the Pension Benefit Guaranty Corporation (PBGC) following the termination of a pension plan are dischargeable as unsecured prepetition claims in bankruptcy. Adopting reasoning advocated by PBGC, the court held that the termination premiums are not claims in the terminating employers' bankruptcy cases, but instead become obligations of the employers only upon their emergence from bankruptcy or case dismissal.

The Second Circuit is the first appeals court to address this issue since a 2005 statute implemented the termination premiums. On its face, the decision gives effect to Congress's apparent intent, which was to make it significantly more expensive for debtors to terminate qualified defined benefit pension plans backstopped by PBGC. There is a question, however, as to whether the court's reasoning may open the door to unintended consequences in future cases.

Background

On March 19, 2006, flatware designer and manufacturer Oneida Ltd. filed for chapter 11 protection, in part to address significant pension liabilities. At the

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1 The author would like to thank Jonathan Armstrong for his assistance in the preparation of this article.

ABI Event Roundup

11th Annual New York City Conference Sets Registration Record at New Venue

More than 570 insolvency professionals attended ABI's 11th Annual New York City Bankruptcy Conference on May 4, 2009. Having outgrown its previous venue, the conference took place for the first time at the beautiful updated New York Marriott Marquis, located in the heart of Times Square and the Broadway theater district. The program brought together a faculty of bankruptcy judges and practitioners from the top national insolvency firms. It offered two plenary sessions—one a roundtable of judges from the Southern and Eastern Districts of New York discussing current topics, and the other a panel of experts discussing past and potential future changes to the Bankruptcy Code. During each of two morning sessions,

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David I. Pauker (Goldin Associates LLC; New York), Arthur J. Steinberg (King & Spalding LLP; New York) and Lisa G. Beckerman (Akin Gump Strauss Hauer & Feld LLP; New York) (l-r) discuss alternative liquidation regimes under banking, securities, insurance and state law.

Leading discussions on recent trends and issues in real estate restructurings were (front row, l-r) Alec P. Ostrow (Stevens & Lee PC; New York), My Chi To (Debevoise & Plimpton LLP; New York), Sanford P. Rosen (Sanford P. Rosen & Associates PC; New York), (back row, l-r) Hon. Cecelia G. Morris (U.S. Bankruptcy Court; Poughkeepsie, N.Y.) and John Pidcock (Bridge Associates LLC; Cleveland).

Howard S. Beltzer (Morgan, Lewis & Bockius LLP; New York), Scott L. Hazan (Otterbourg, Steindler, Houston & Rosen PC; New York), Hon. Martin Glenn (U.S. Bankruptcy Court; New York), William H. Henrich (Getzler Henrich & Associates LLC; New York) and Evan C. Hollander (White & Case LLP; New York) (l-r) led a session on reclamation claims and leases in retail bankruptcies.

Premiums Payable to PBGC after Termination Not Dischargeable

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filed for chapter 11 protection, in part to address significant pension liabilities. At the outset of its case, Oneida moved to terminate its three underfunded pension plans, arguing that it had no hope of a successful reorganization if it were forced to maintain them. Oneida ultimately reached an agreement with PBGC, pursuant to which Oneida agreed to give PBGC a $3 million note and to maintain two smaller plans. The PBGC agreed to terminate and take over a much larger plan from Oneida that covered more than 1,900 workers (the "Oneida plan"). It was projected that Oneida would have owed close to $30 million in funding obligations in connection with the Oneida plan over the next three years.

When a pension plan covered by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §1301-1461, is terminated, PBGC takes over the plan's assets and provides for future payments to plan beneficiaries, up to certain statutory limits. Prior to enactment of the Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat. 4 (Feb. 8, 2006), employers often relied on distressed terminations of underfunded, defined-benefit pension plans in bankruptcy as a way of facilitating their reorganizations. By Sept. 30, 2006, PBGC was obligated to pay benefits to approximately 1.3 million beneficiaries of failed plans, was operating under an $18.88 billion deficit and had projected long-term obligations well in excess of its projected cash flows.[2]

In an effort to shore up PBGC's finances, Congress included an amendment to §4006(a)(7) of ERISA in the Deficit Reduction Act of 2005 (the 2005 amendment).[3] The 2005 amendment, enacted approximately one month before Oneida filed for chapter 11, requires employers that terminate qualified defined benefit pension plans to pay PBGC the termination premiums, which are annual payments equal to $1,250 per beneficiary.

With respect to employers not in bankruptcy, the termination premiums are payable for three years following termination of a plan (the general rule). However, if an employer terminates a plan while in bankruptcy, the first of the three resultant termination premiums does not come due "until [one month after] the date of the discharge or dismissal of such person in such [bankruptcy] case." ERISA §4006(a)(7), 29 U.S.C. §1306(a)(7). This postponement of the termination premiums for employers in bankruptcy is referred to as the "special rule."

In their settlement, Oneida and PBGC expressly reserved their rights to dispute whether PBGC would be entitled to receive termination premiums on account of the termination of the Oneida plan, and Oneida was required, by the terms of the settlement, to pay the termination premiums into an escrow account pending resolution of the issue. The escrow agreement negotiated by Oneida and PBGC provided that the escrowed funds would be returned to Oneida if a final order was entered determining that the termination premiums constituted "claims" subject to discharge under §1141(d) of the Bankruptcy Code. *See* Brief of Appellee at 10-11, *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, No. 08-2964-bk (2d Cir. Nov. 10, 2008).

Bankruptcy Court Proceedings

At the completion of its chapter 11 case, Oneida brought an action against PBGC in the U.S. Bankruptcy Court for the Southern District of New York seeking a determination that Oneida did not owe termination premiums on account of the termination of the Oneida plan. With 1,920 workers and retirees covered by the Oneida plan, the termination premiums would have cost Oneida approximately $2.3 million per year for the next three years.

In its complaint, Oneida argued that the obligation to pay the termination premiums was a contingent "claim" under §101(5)(A) of the Code that was validly discharged in Oneida's plan of reorganization pursuant to §1141(d) of the Bankruptcy Code. The bankruptcy court agreed, pointing out that "contingent" and "unmatured" rights of payment are included in the definition of "claims" under §101(5)(A). *In re Oneida Ltd.*, 383 B.R. 29, 37 (Bankr. S.D.N.Y. 2008). The court held that the termination premiums are "a classic contingent claim." *Id.* at 38. Upon termination of a covered plan in a bankruptcy case, the claim "is contingent and becomes enforceable only after the debtor receives a discharge or the court case is dismissed. However, the [2005 amendment] creates a liability to PBGC—a claim—for all companies that effect a distress termination of a covered pension plan during a reorganization proceeding." *Id.*

The bankruptcy court held that Oneida's obligation to pay the termination premiums was a prepetition claim. *Id.* at 42-45. Relying on the Second Circuit's decision in *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997 (2d Cir. 1991) (*Chateaugay I*), the bankruptcy court held that, "in determining when a contingent claim arises, the critical factor is whether, at the time of the [debtor's chapter 11] petition, the parties contemplated that the contingent obligation would exist if the contingency occurred." *In re Oneida Ltd.*, 383 B.R. at 43.

Since the 2005 amendment had already been enacted and Oneida and PBGC had held discussions regarding possible plan termination prior to Oneida's chapter 11 filing, the bankruptcy court held that the ultimate claim on account of the termination premiums was sufficiently within the parties' contemplation prior to Oneida's chapter 11 filing to make it a prepetition claim. *Id.* at 43-44.

Second Circuit Decision

PBGC appealed the bankruptcy court's decision, and the Second Circuit agreed to hear the appeal directly pursuant to a new provision added to 28 U.S.C. §158 in 2005, which grants federal appellate courts jurisdiction to hear appeals directly from the bankruptcy court, thereby bypassing the district court, in cases that "involve...a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involve...a matter of public importance." 28 U.S.C. §158(d)(2). *See Pension Benefit Guaranty Corp. v. Oneida Ltd.*, No. 08-2964-bk (2d Cir. Aug. 29, 2008).

On appeal, PBGC argued that the bankruptcy court erred in holding that the obligation to pay termination premiums was a "claim" in Oneida's chapter 11 case. PBGC relied on the Second Circuit's decision in *LTV Steel Co. v. Shalala (In re Chateaugay Corp.)*,

2 *See PBGC 2006 Annual Report*, www.pbgc.gov/docs/2006_annual_report.pdf.

3 The 2005 Amendment was subsequently permanently enacted in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (Aug. 17, 2006).

53 F.3d 478 (2d Cir. 1995) (*Chateaugay II*), for the proposition that a bankruptcy claim does not arise until the claimant possesses a right of payment. *See* Brief of Appellant at 22, *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, No. 08-2964-bk (2d Cir. Nov. 10, 2008).

In PBGC's view, the effect of the special rule was to give PBGC a right of payment with respect to termination premiums on account of pension plans terminated in bankruptcy only after the conclusion of the employer's bankruptcy case. *Id.* at 28. As PBGC argued in its reply brief to the Second Circuit, "[b]ecause the Termination Premium is not a pre- or postpetition bankruptcy claim under the *Chateaugay II* test, the liability cannot be discharged under the Bankruptcy Code or Oneida's plan of reorganization." *See* Reply Brief of Appellant at 3, *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, No. 08-2964-bk (2d Cir. Nov. 10, 2008).

The Second Circuit sided with PBGC and overturned the bankruptcy court's decision. The court held that *Chateaugay II* provides the relevant test, and that application of the special rule means that the obligation of a debtor-employer to pay termination premiums does not, in any sense, arise prior to the employer's emergence from chapter 11 or the dismissal of its case. *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, 2009 WL 929528, at *2. Addressing the bankruptcy court's decision, the Second Circuit wrote:

> This, then, is not a situation, as the bankruptcy court erroneously thought, where an obligation has already been created prior to bankruptcy but is subject to a contingency. Rather, an employer's obligation to pay a Termination Premium on a pension plan that is terminated during the course of the bankruptcy does not even arise until the bankruptcy itself is terminated. No matter how broadly the term "claim" is construed, it cannot extend to a right to payment that does not yet exist under federal law.

Id. (internal citations omitted).

The court noted that the bankruptcy court's holding, if upheld, would thwart Congress's clear intent that the termination premiums would be payable in full after the employer's emergence from bankruptcy.

Future Implications

The Second Circuit's decision is one of first impression among the federal courts of appeal. Accordingly, and particularly given how well-respected the Second Circuit is among other courts, this decision is likely to be relied upon by other courts faced with this issue. The Second Circuit's treatment of termination premiums as nondischargeable obligations of reorganized employers, rather than prepetition claims in the debtor-employer's bankruptcy case, gives effect to Congress' apparent intent to make it more expensive for debtors to terminate qualified defined-benefit pension plans as part of corporate reorganizations. This will make it more costly for some employers to terminate underfunded legacy plans, which ultimately will reduce recoveries for other creditors and potentially could inhibit some debtors from successfully reorganizing.

It is possible that the Second Circuit's reasoning may open the door to certain unintended consequences in future cases. As discussed above, PBGC successfully argued that Oneida's obligation to pay termination premiums did not result in PBGC holding a claim in Oneida's chapter 11 case. PBGC may have felt compelled to make this argument because of the terms of the escrow agreement that it had entered into with Oneida, under which Oneida would have been entitled to receive the escrow amount if a final order were entered determining that the termination premiums were "claims" subject to discharge under §1141(d) of the Bankruptcy Code. Otherwise, PBGC may have argued that its right to receive termination premiums arose as a contingent claim during Oneida's chapter 11 case when the Oneida plan was terminated. This would have given PBGC a postpetition administrative priority claim in Oneida's chapter 11 case, rather than simply removing the obligation to pay termination premiums from the bankruptcy process altogether.

There are several ways in which an allowed administrative claim against a chapter 11 debtor may be preferable to a nonbankruptcy right to payment by the reorganized debtor post-emergence. First, in the event that a debtor is ultimately unable to successfully reorganize and liquidates before emerging from bankruptcy, the Bankruptcy Code provides priority of payment protections for holders of allowed administrative claims that would not be available to those whose rights would arise only upon emergence or dismissal of the debtor's case. Second, for a plan of reorganization to be confirmable under the Bankruptcy Code, it must provide for payment in full of allowed administrative claims. *See* Bankruptcy Code §1129(a)(9). There is no such requirement regarding nonbankruptcy obligations that have not yet accrued. Whereas a holder of an allowed administrative claim has direct resort to the bankruptcy court if a proposed plan of reorganization (and the financial projections supporting such plan) does not contemplate paying them in full, a holder of a not-yet-accrued nonbankruptcy obligation would have to wait until postemergence and then seek relief in nonbankruptcy court if its payments were not ultimately made.

If the reorganized debtor filed for bankruptcy a second time before making the payments, the holder would be left with just a claim in a second bankruptcy case. It remains to be seen whether debtors in future cases will seek to use PBGC's reasoning regarding the status of termination premiums against it in any future cases. ■

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