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Not So Fresh Start — Reorganized Debtors Liable for Pension Termination Premiums

On April 8, 2009, in a case of first impression that will impact debtors who terminate a pension plan in a reorganization bankruptcy case, the Court of Appeals for the Second Circuit, held that under 2005 amendments to the Employee Retirement Income Security Act of 1974 ("ERISA"), such debtors are required to pay a so-called "termination premium" to the Pension Benefit Guaranty Corp. ("PBGC") **after** emerging from bankruptcy.[1] This liability, which could exceed millions of dollars for many employers, could keep a company from obtaining the financing necessary to leave bankruptcy.

This ruling overturned the decision of the Bankruptcy Court for the Southern District of New York, which found that the termination premiums arose prepetition and were thus discharged by the confirmation of the debtor's reorganization plan, explicitly rejecting the PBGC's arguments that the claims did not arise until post-confirmation.[2]

The Deficit Reduction Act of 2005

The Deficit Reduction Act of 2005 (the "DRA"), Pub. L. No. 109-171, 120 Stat. 4 (Feb. 8, 2006)[3], included, among other things, 29 U.S.C. § 1306(a)(7), which provides that companies that terminate their pension plans while reorganizing under the Bankruptcy Code are required to pay the PBGC a termination fee of $1,250 a year for three years for each plan participant (totaling $3,750 per plan participant) (the "Termination Premium"). The first Termination Premium is not due "until the date of the discharge or dismissal of such person in such [bankruptcy] case." ERISA § 4006(a)(7). Before the DRA was enacted, if a bankruptcy judge found that a debtor met the statutory criteria for a distress termination of its pension plan, the debtor could then emerge from bankruptcy free of its pension liabilities.

Background of Oneida

On March 19, 2006, just weeks after the DRA passed, Oneida Ltd., a designer and manufacturer of silverware and flatware, filed for bankruptcy and shortly thereafter terminated one of its single-employer, defined-benefit pension plans covering approximately 1,900 workers. After Oneida's bankruptcy reorganization plan was confirmed by the bankruptcy court in August 2006, Oneida and the PBGC entered into a stipulation pursuant to which (i) Oneida provided the PBGC with a $3 million promissory note on account

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1 *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, 2009 WL 929528 (2d Cir. Apr. 8, 2009).

2 *In re Oneida Ltd.*, 383 B.R. 29 (Bankr. S.D.N.Y. 2008).

3 These provisions were later permanently enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (Aug. 17, 2006), § 401(b), which removed a sunset provision and made a technical correction, and codified at 29 U.S.C. § 1306(a)(7).

of the terminated pension plan and (ii) Oneida and the PBGC agreed to reserve their right to litigate the Termination Premium until a later date. Oneida emerged from bankruptcy in September 2006.

Seeking to avoid payment of the approximately $6.9 million Termination Premium, Oneida sought a declaratory judgment that the Termination Premium was an unsecured, prepetition bankruptcy claim, and together with the PBGC's other claims, were satisfied by the $3 million note and was thus discharged by its reorganization plan.

Under the Bankruptcy Code, a creditor's right to payment from the debtor can be discharged in bankruptcy so long as it falls within the scope of the term "claim" and arose prior to the confirmation of the debtor's chapter 11 plan. Focusing on the broad definition of "claim," the bankruptcy court held that because Oneida's pension plan was terminated prior to the confirmation date, the Termination Premium was a prepetition contingent claim, and thus dischargeable.

On May 12, 2008, Oneida and the PBGC jointly appealed the bankruptcy court decision.

The Second Circuit's Ruling

In its opinion, the Second Circuit reversed and found that the DRA unambiguously states that where a pension plan is terminated in connection with a bankruptcy proceeding, the PBGC's right to a Termination Premium does not arise until after the effective date of a plan of reorganization. Thus, the Termination Premium could not be considered a prepetition debt stating, "[t]he obvious purpose of this rule is to prevent employers from evading the termination premium while seeking reorganization in bankruptcy."

Furthermore, the court found that the Termination Premium was "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," further finding that the requirement to pay the Termination Premium "does not arise" until after the conclusion of the bankruptcy case. The court further reasoned that treating the Termination Premium as a prepetition claim that could be discharged in bankruptcy would "thwart Congress's aim" in vacating the special rules pertaining to the premiums.

In its opinion, the Second Circuit did not address Oneida's other contention that if Congress had wanted to specifically amend the Bankruptcy Code to exclude the Termination Premium from being treated as a claim, it could have done so directly instead of amending ERISA.

Impact on Pending and Future Bankruptcy Cases

The Second Circuit's opinion will impact numerous pending and future bankruptcy cases because of the millions of dollars that a debtor will be liable for after it exits bankruptcy if it terminates a pension plan.

While considered largely a debtor-friendly venue, until other circuit courts decide the issue, the Second Circuit may become less desirable for companies whose reorganization plans include terminating their pension plans. These companies may choose to file in other jurisdictions, hoping that the circuit courts in such jurisdictions disagree with the *Oneida* decision and find that the Termination Premium impairs a debtor's ability to reorganize and should be considered a prepetition claim, dischargeable in bankruptcy.

Other courts may also find persuasive Oneida's argument that Congress should have amended the Bankruptcy Code, not ERISA, if it intended to alter a debtor's post-bankruptcy obligations resulting from actions taken during the course of a bankruptcy case.

Companies currently in chapter 11 will also be impacted by the Second Circuit's decision if they intend on emerging from bankruptcy without their pension plans. The burden of a large Termination Premium may limit their ability to come out of chapter 11 because of their inability to finance such a premium.

Conclusion

The effect of the *Oneida* holding will play out over the coming months and years. While debtors in current and future bankruptcy cases outside of the Second Circuit will argue that the Second Circuit erred in its analysis of the date a Termination Premium arises, all reorganizing debtors who terminate their pension plans in bankruptcy must nevertheless be prepared to pay the Termination Premium over a three-year period following their bankruptcy cases.

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