RECENT SECOND CIRCUIT DECISION AFFECTS PENSION PLAN CLAIMS IN BANKRUPTCY

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To Our Clients and Friends:

In April 2009, in a case of first impression, the Second Circuit held that "termination premiums" payable to the Pension Benefit Guaranty Corporation ("PBGC") were not prepetition claims that could be discharged in a Chapter 11 bankruptcy proceeding. This case, *Pension Benefit Guaranty Corporation v. Oneida Ltd.*, may alter the landscape in Chapter 11 bankruptcy proceedings in which debtors turn their underfunded pension plans over to the PBGC as part of a plan of reorganization.

BACKGROUND

Enacted in 2006 as part of the Deficit Reduction Act of 2005, Section 4006(a)(7)(A) of the Employee Retirement Income Security Act of 1974 provides that, where the PBGC or a plan sponsor terminates an underfunded pension plan during a Chapter 11 bankruptcy proceeding, the plan termination triggers a liability for special "termination premiums." The termination premiums equal $1,250 per plan participant per year and are payable for each of the three years following the exit from Chapter 11. (For example, in a plan with 5,000 participants, the termination premiums would equal $18.75 million.) The debtor and every member of the debtor's "controlled group" (essentially all entities connected to the debtor through 80% ownership, including brother-sister companies) are liable to the PBGC for these payments. This provision of ERISA was initially scheduled to sunset in 2011, but was made permanent in 2006 as part of the Pension Protection Act.

In March 2006, Oneida Ltd., a manufacturer and designer of flatware, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. At that time, Oneida sponsored three defined benefit pension plans. The PBGC and Oneida reached a settlement regarding these plans whereby the PBGC agreed to terminate one of these plans, and Oneida agreed to provide the PBGC with a $3 million note. Both parties reserved their rights to litigate whether the PBGC's claim for termination premiums could be discharged as part of the Chapter 11 bankruptcy proceeding. The value of the PBGC's unsecured claim was stipulated to be $21 million, although the PBGC argued that the actual value of its claim was $56 million—ultimately an academic point as unsecured creditors received no recovery under the debtor's plan of reorganization. After Oneida emerged from bankruptcy protection, the PBGC demanded payment of the termination premiums. Oneida in turn initiated an action to have the bankruptcy court declare that the PBGC's claims for termination premiums were prepetition claims discharged in connection with the confirmation of Oneida's plan of reorganization. The PBGC contended that the termination premiums were not "claims"—and as a result were not discharged at confirmation—because the obligation to pay the termination premiums did not arise until Oneida emerged from bankruptcy. The Bankruptcy Court ruled in favor of Oneida, holding that the termination premiums were claims discharged at confirmation.

THE SECOND CIRCUIT DECISION

The Court of Appeals reversed the bankruptcy court and held that the liability to the PBGC for termination did not arise until Oneida emerged from bankruptcy. The Second Circuit concluded that Section 4006(a)(7)(A) was clear on its face (and with respect to legislative intent) that an employer's obligation to pay termination premiums does not arise until emergence from Chapter 11. According to the Second Circuit, "[t]he obvious purpose of this rule [was] to prevent employers from evading the Termination Premium while seeking reorganization in bankruptcy." Hence the liability for termination premiums is not a claim in bankruptcy and cannot be discharged as part of the bankruptcy proceeding.

THE IMPLICATIONS OF THE DECISION

Whenever an underfunded pension plan sponsor files for Chapter 11 bankruptcy protection, the stakes for the PBGC are high. If the debtor terminates the pension plan in the bankruptcy, the PBGC receives a claim for the plan underfunding, but—despite strong efforts (and limited success) on the PBGC's part to obtain higher priority—this claim is often a prepetition unsecured claim. Thus, the PBGC typically recovers far less than full value on its unsecured claim. In the Oneida bankruptcy, for example, the PBGC received no recovery on its unsecured claim. The PBGC's right to collect termination premiums after the conclusion of a Chapter 11 case operates to enhance the PBGC's recovery from the reorganized debtor in a way unavailable to other creditors, secured or unsecured.

The impact of the *Oneida* decision is still unclear and it remains to be seen whether other circuits will follow the decision. It is also too soon to tell whether the decision will influence how debtors structure their Chapter 11 reorganizations, but it is clear that both creditors and debtors will need to closely examine the possibility for termination premiums when analyzing the economics of a plan of reorganization and the balance sheet and cash flow of a reorganized debtor.

Please feel free to contact us with any questions.

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