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PENSION PLAN TERMINATION PREMIUM CLAIMS MAY NOT BE DISCHARGEABLE IN BANKRUPTCY

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The Supreme Court declines to review a circuit court decision in Oneida Ltd., which held that a debtor cannot discharge in bankruptcy, as a prepetition claim, premiums it owes to the Pension Benefit Guaranty Corporation in connection with the termination of a pension plan.

Introduction

Many companies seeking Chapter 11 protection in the recent economic downturn included among their woes large unpaid defined benefit pension obligations. These woes were compounded by the employers' inability to stay current with ongoing pension contributions owed to their tax-qualified pension plans. Benefit obligations under most tax-qualified pension plans are insured up to certain limits by the Pension Benefit Guaranty Corporation ("PBGC"), a federal agency. One measure intended to help fund the PBGC is the requirement that employers terminating qualified pension plans pay to the PBGC a "termination premium" per plan participant. Companies often file for

the protection of Title 11 of the United States Code seeking to discharge some or all of their pension obligations. As part of such a filing, companies also often seek to discharge their termination premium obligations.

Until recently, bankruptcy courts generally held that PBGC claims for termination premiums stemming from a company's termination of its PBGC-protected pension plans are "unsecured claims," a type of claim often discharged in a Chapter 11 bankruptcy. In fact, Chapter 11 became a tool for employers to escape or reduce those payment obligations.

As a result, it was not surprising when in 2008, in the case of Oneida Ltd. ("Oneida"), a Bankruptcy Court in the Southern District of New York continued to treat termination premiums as contingent unsecured claims. The Court held that "termination premiums" created by the Deficit Reduction Act of 2005, and memorialized in Section 4006 of the Employee Retirement Income Security Act ("ERISA"), constituted unsecured prepetition claims, albeit contingent as of the filing date, and

were dischargeable in bankruptcy. On appeal from the Bankruptcy Court, the Second Circuit reversed that principle, holding instead that the PBGC's right to recover the termination premiums arising under Section 4006(a)(7)(A) and (B) of ERISA with respect to a post-petition termination of a defined benefit pension plan was not an unsecured prepetition claim because the termination premium claim arose after the filing of the bankruptcy case.¹ Since the claim failed to qualify as a prepetition unsecured claim, Oneida was required to honor its obligations to the PBGC for the termination premiums. Oneida appealed to the United States Supreme Court.

On December 14, 2009, the Supreme Court denied Oneida's petition for a *writ of certiorari* and declined to review the Circuit Court's decision.² The Supreme Court's decision to abstain from review of the Second Circuit decision in Oneida reinforces the notion that an employer that terminates a tax-qualified pension

plan during, as opposed to before, the pendency of its bankruptcy case, will not be able to use the bankruptcy as a tool to discharge its termination premium obligations to the PBGC.

Facts Underlying the PBGC's "Claim" in Oneida:

At issue in the Oneida bankruptcy case was how to characterize termination premium obligations owed to the PBGC for purposes of bankruptcy. Oneida's position was that its obligation to the PBGC under Section 4006(a)(7)(A) and (B) of ERISA constituted a prepetition unsecured claim as defined by Section 101(5) of the Bankruptcy Code, which could be discharged in bankruptcy. The PBGC's position was that the obligation under Section 4006(a)(7)(A) and (B) of ERISA for a defined benefit pension plan that is terminated during a bankruptcy proceeding arises upon the company's emergence from or dismissal of its bankruptcy case, which would make such claims immune from the then pending bankruptcy proceeding.

While in bankruptcy, Oneida consensually terminated one of its single-employer, defined benefit pension plans. Section 4006(a)(7)(A) of ERISA provides, as a general rule, that "[i]f there is a termination of a single-employer plan . . . , there shall be payable to the [PBGC], with respect to each applicable 12-month period, a premium at a rate equal to \$1,250 multiplied by the number of individuals who were participants in the plan immediately before the termination date." A special rule

applies, however, if the plan is terminated while the debtor is trying to reorganize under Chapter 11 of Title 11 of the United States Code (i.e., is in bankruptcy proceedings) (or analogous State law relating to insolvency), . . . "until the date of the discharge or dismissal of [the employer] in such case." Under this "special rule," embodied in Section 4006(a)(7)(B) of ERISA, the applicable 12-month period does not commence until "the first month following the month which includes the earlier date as of which each [employer] is discharged or dismissed" from the bankruptcy proceeding.

Following Oneida's post-petition termination of its pension plan, the Bankruptcy Court granted Oneida's motion for summary judgment. The Bankruptcy Court held that the PBGC's claims for termination premiums under ERISA came under the expansive definition of the term "claim" set forth in Title 11 and case law interpreting it.³ Finding the termination premium obligations to be a "claim" meant that they would be dischargeable in bankruptcy. The Bankruptcy Court noted the "contingent" aspect of the termination premium obligations as of the bankruptcy case filing date, but did not find that the contingency rendered the obligations a post-petition claim arising during the case. Characterizing the obligations as a post-petition claim would have put them outside of the reach of the then pending bankruptcy proceeding or, alternatively, could have transformed them into "administrative claims"

affording them preferential treatment among creditors.

The Second Circuit disagreed with Oneida's position that the PBGC's right to termination premiums is governed entirely by the Bankruptcy Code. Stating that the definition of a "claim" under the Bankruptcy Code is "not infinite," the Second Circuit focused on the language of ERISA itself, and in particular the "special rule" deferring payment until after the employer emerges from bankruptcy. Applying the "special rule" discussed above, the Second Circuit found that "the liability for the termination premium *does not arise* until the employer is discharged from the reorganization proceeding." Accordingly, the Second Circuit held that the termination premium cannot be affected by the bankruptcy case even though the pension plan was terminated during the company's bankruptcy proceeding.

The Second Circuit based its holding on the plain language of the termination premium rules (codified in ERISA Section 4006(a)(7)(A) and (B) which was enacted in 2005) as well as Congress' stated intent, in enacting the rules, to require employers terminating plans while in bankruptcy to pay termination premiums. The Court cited the Committee's statement that "The bankruptcy courts should not be used as a mechanism for eliminating the burden of an underfunded pension plan; therefore an additional premium paid to the PBGC to recognize the agency's assumption of unfunded plan liabilities is reasonable."

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Conclusion

The Second Circuit's holding in *Oneida* and the Supreme Court's decision not to get involved significantly changes the bankruptcy landscape and treatment of pension termination premium claims in future bankruptcy cases, at least in the Second Circuit. These decisions make clear that companies will be unable to use Chapter 11 to both terminate their underfunded pension plan and jettison their pension termination premium obligations arising under Section 4006(a)(7)(A) and (B) of ERISA. They also suggest that the PBGC's termination premium claims now garner a superior treatment in future Chapter 11 reorganization cases, potentially resulting in lesser distributions to other creditors holding general unsecured claims. In the most difficult cases, the inability to have

termination premiums discharged in bankruptcy may produce an insurmountable hurdle to a company's ability to exit the Chapter 11 process as a reorganized entity, at least in the Second Circuit and those Circuits that follow its lead.

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¹ Pension Benefit Guaranty Corp. v. Oneida, Ltd., 562 F.3d 154 (2d Cir. 2009).

² Oneida Ltd. v. Pension Ben. Guar. Corp.,-- S.Ct. --, 2009 WL 3316342 (Dec. 14, 2009).

³ Section 101(5) of Title 11 defines Claim as a:

(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.

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