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A Call to Companies with PBGC Liabilities: Second Circuit Finds Pension Plan "Termination Premiums" Not Dischargeable in Bankruptcy

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In a case of first impression issued on April 8, 2009, the Court of Appeals for the Second Circuit held that "termination premiums," payable to the Pension Benefit Guaranty Corporation (the "PBGC")[1] under ERISA, are not prepetition claims subject to discharge in a chapter 11 bankruptcy proceeding.[2] Instead, these claims are considered to arise post-petition at the time the debtor is discharged.

The PBGC, the federal agency charged with administering the federal pension plan insurance program, is often a major creditor in large corporate bankruptcies. Pension plan terminations in the chapter 11 context typically trigger large general unsecured claims in favor of the PBGC, but these claims are not entitled to special distribution rights and are subject to at least partial discharge. The Second Circuit's decision does not alter this result, but, significantly, it gives the PBGC an additional avenue for recovery by allowing it to fully recoup its claim for termination premiums where the pension plan is terminated post-petition. This new remedial option for the PBGC may pose practical difficulties for the many companies that will now be unable to avoid substantial non-dischargeable PBGC liabilities in those jurisdictions where the Second Circuit's decision is followed. Depending on the size of the termination premium, distributions to unsecured creditors are likely to be impacted.

Payments to the PBGC

The amount and priority of the PBGC's claims are generally governed by ERISA and the Internal Revenue Code (the "Code"). The Deficit Reduction Act of 2005 (the "DRA") amended ERISA to create a termination premium that must be paid to the PBGC by companies that terminate certain covered pension plans under specified circumstances.[3] This termination premium is in addition to the PBGC's claim for underfunding as of the termination date.[4] These premiums apply in certain "distress" terminations initiated by the employer as well as certain involuntary terminations initiated by the PBGC. Termination premiums do not, however, apply to terminations resulting from the liquidation of a company under chapter 7 of the Bankruptcy Code or in similar state law proceedings.[5]

Upon termination of certain single-employer plans, the employer must pay to the PBGC each month for a three-year period an amount equal to $1,250 multiplied by the number of plan participants immediately before the termination date.[6] Generally, the termination premiums are payable starting on "the first month following the month in which the termination date occurs."[7] However, there is a "Special Rule" that applies during a bankruptcy proceeding under chapter 11 of the Bankruptcy Code, pursuant to which the termination provision set forth above does "not apply to such plan until the date of the discharge or dismissal of [the employer] in such case."[8] These termination premiums are payable starting on the first month following the month of the employer's discharge or dismissal.[9]

Oneida

In March 2006, Oneida Ltd. ("Oneida"), a designer and manufacturer of flatware, filed a voluntary petition for reorganization under chapter 11 of the Bankruptcy Code. While in bankruptcy, Oneida terminated one of its single-employer, defined-benefit pension plans, and each of the PBGC and Oneida reserved its rights to dispute or enforce the payment of termination premiums. Oneida then sought a declaratory judgment that the applicable termination premium was an unsecured prepetition claim that had been discharged in the bankruptcy proceeding.

The Bankruptcy Court for the Southern District of New York held that the termination premiums were dischargeable prepetition claims.[10] The Bankruptcy Court reasoned that the termination premiums were "classic contingent claim[s]" under the Bankruptcy Code that become enforceable after the debtor receives a discharge or the case is dismissed.[11] Further, the Bankruptcy Court determined that there was no evidence of congressional intent to amend the Bankruptcy Code and create a new nondischargeable debt for the benefit of the PBGC.[12]

On April 8, 2009, the Court of Appeals for the Second Circuit reversed the ruling of the Bankruptcy Court and held that "termination premiums" payable to the PBGC are not prepetition claims dischargeable in a chapter 11 bankruptcy proceeding, but rather, under federal law, arise after the bankruptcy is terminated.[13] The Court of Appeals reasoned that the term "claim" cannot extend to a right to payment that does not yet exist, and in this case, the statute provides that the termination provision does not apply until after the bankruptcy proceeding is discharged or dismissed.[14] The Second Circuit noted that the legislative history of the DRA indicates that the termination premiums "were established in response to mounting financial pressure on the PBGC as a result of an increasing number of pension plan terminations."[15] According to the Court, Congress recognized that the termination premiums could be jeopardized by employers seeking bankruptcy protection, and as a result, the DRA "*explicitly* discusses how the obligation should be treated in bankruptcy."[16]

Conclusion

The *Oneida* case is the first reported case to interpret this particular provision of the DRA, and it is not yet clear whether this decision will be widely accepted. Nevertheless, the decision may potentially have a significant impact on those companies considering, or that become the subject of, a distress termination of their pension plans in the context of a chapter 11 proceeding. In circumstances where *Oneida* is followed, the financial obligations imposed on the debtor will be increased and unsecured creditors may recover less as additional assets are diverted to the PBGC. Depending on the level of employee participation in the terminated pension plan, such liability can be substantial and could affect the terms of any plan of reorganization proposed and confirmed by the debtor. Ultimately, this expense will be borne by the debtor's other creditor constituents.

Footnotes

[1] PBGC was established under the Employee Retirement Income Security Act of 1974 ("ERISA"). 29 U.S.C. §§ 1301-1461.

[2] *Pension Benefit Guar. Corp. v. Oneida, Ltd.*, 2009 U.S. App. LEXIS 7176 (2d Cir. April 8, 2009), *rev'g Oneida Ltd. v. Pension Benefit Guar. Corp.*, 383 B.R. 29 (Bankr. S.D.N.Y. 2008).

[3] Deficit Reduction Act of 2005, Pub. L. 109-171, 120 Stat. 180 (Feb. 8, 2006).

[4] 29 U.S.C. § 1306(a)(7)(A).

[5] 29 U.S.C. § 1306(a)(7)(A).

[6] 29 U.S.C. § 1306(a)(7).

[7] 29 U.S.C. § 1306(a)(7)(C)(i).

[8] 29 U.S.C. § 1306(a)(7)(B).

[9] 29 U.S.C. § 1306(a)(7)(B) and (C)(ii).

[10] *Oneida*, 383 B.R. 29.

[11] *Id.* at 38.

[12] *Id.* at 41.

[13] *Oneida*, 2009 U.S. App. LEXIS 7176.

[14] *Id.* at *8.

[15] *Id.* at *8.

[16] *Id.* at *7.