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Distress Terminations

This article examines the recent decision of the Second Circuit Court of Appeals in *Pension Benefit Guaranty Corporation v. Oneida Ltd.* The author discusses the unusual procedural background of the case and draws conclusions regarding the implications of the decision.

Second Circuit Victory for PBGC in *Oneida* Will Make Distress Terminations in Bankruptcy More Expensive

BY JEFFREY B. COHEN

Introduction

In the first case involving the new ''termination premium,'' the U.S. Court of Appeals for the Second Circuit recently—and surprisingly—reversed a lower court decision that was adverse to the Pension Benefit Guaranty Corporation (''PBGC''). Unless and until there is a divergent ruling from another circuit, the decision in *Pension Benefit Guaranty Corporation v. Oneida, Ltd.*,[1] (67 PBD, 4/10/09; 36 BPR 910, 4/14/09), means that PBGC's termination premium must be paid in real, post-bankruptcy dollars, rather than resolved and discharged like other bankruptcy claims, and paid only cents on the dollar. PBGC's victory at the appellate level was surprising because the Second Circuit has not been kind to the agency in the past when addressing the interplay between bankruptcy law and ERISA.

Before analyzing the implications of the decision handed down April 8, 2009 in *Oneida*, let's first discuss the enactment of the termination premium, the launching of the test case in *Oneida* soon thereafter, and the unusual procedural path this case took to the court of appeals.

Enactment of Termination Premium

In early 2006, Congress passed the inaptly named Deficit Reduction Act of 2005 (''DRA''), which was signed by the President on February 8, 2006.[2] It amended ERISA section 4006 to add a new premium of $1,250 per participant per year for three years after a plan is terminated, whether through a distress termination or one initiated by PBGC, and whether inside or outside of bankruptcy. The provision, which was originally enacted as a temporary measure, was made permanent in the Pension Protection Act of 2006 (''PPA''), enacted a few months later in August 2006.[3] Notably, the amendment provided that if a plan is terminated during a bankruptcy reorganization proceeding, the termination premium does not become due until after the debtor has emerged from bankruptcy, while a company that liquidates in bankruptcy incurs no premium. PBGC

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[1] *Pension Benefit Guar. Corp. v. Oneida Ltd.*, No. 08-2964, 2009 U.S. App. LEXIS 7176 (2d Cir. April 8, 2009).

[2] Pub. L. 109-171, 120 Stat. 4 (2006).

[3] Pub. L. 109-280, 120 Stat. 780 (2006).

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takes the position, however, in its regulation, that if less than all members of a controlled group are liquidating, the termination premium applies to the non-liquidating members.[4] Specifically, the ''General Rule'' provides that

> [i]f there is a termination of a single-employer plan [under specified circumstances], 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.[5]

Significantly, however, the ''Special Rule'' provides that if a plan is terminated during a bankruptcy reorganization proceeding:

> [the General Rule] shall not apply to such plan until the date of discharge or dismissal of [the debtor] in such case.[6]

Under the General Rule, the ''applicable 12-month period'' runs from the ''first month following the month in which the termination date occurs'' and requires payment for a total of three years. Under the Special Rule, the applicable 12-month period does not begin until ''the first month following the month which includes the earliest date as of which each [debtor] is discharged or dismissed'' from the bankruptcy proceeding.[7] Enacted against the backdrop of successive pension terminations in the reorganization cases of high profile steel and airline companies, the shedding of pension plans during bankruptcy was perceived as having become too easy. As the House Committee on Education and the Workforce put it:

> [T]he Committee believes that a termination premium for former plan sponsors who initiate and complete a distress termination while in bankruptcy is appropriate. 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.[8]

Therefore, ''[i]n the case of termination due to reorganization, the liability for the [termination] premium does not arise until the employer is discharged from the reorganization proceeding.''[9] Clearly, this provision was enacted as a deterrent to the successful use of bankruptcy reorganization to shift the legacy liability to PBGC.

Oneida Challenge to Termination Premium

Oneida, Ltd. (''Oneida''), the flatware maker, filed a ''pre-negotiated'' bankruptcy on March 19, 2006.[10] During the course of its reorganization proceedings, it terminated one, but not all, of its pension plans, and entered into a settlement agreement with PBGC that resolved PBGC's claims for delinquent minimum funding contributions (for which PBGC had perfected liens), employer liability under section 4062 of ERISA, and ''traditional'' premium claims. Although there was some dispute about it, that agreement preserved Oneida's right to challenge PBGC's assertion of the new termination premium, and PBGC reserved its right to assess the new premium. When Oneida emerged from bankruptcy on September 15, 2006, it was the first reorganized company subject to the new assessment. Not surprisingly, being the first such company and being in a venue historically receptive to challenges involving PBGC's claims in bankruptcy,[11] Oneida filed a declaratory judgment action in the bankruptcy court. This test case sought a declaration that the termination premium claims were pre-petition claims, and therefore resolved by the settlement agreement and forever discharged by the confirmation of Oneida's bankruptcy plan of reorganization.

PBGC countered with a motion to withdraw the reference and have the case heard by the district court, on the grounds that its resolution required substantial and material consideration of ERISA as well as bankruptcy law. Consistent with the trend in these matters, Judge Miriam Cedarbaum of the district court denied PBGC's motion, finding that the determination of what is a ''claim'' and whether it was discharged is something that bankruptcy courts routinely do, and thus required merely a ''simple application'' rather than a ''significant interpretation'' of the new provision of ERISA which introduced the termination premium.[12]

Back ''downstairs,'' on cross motions for summary judgment, Bankruptcy Judge Allan Gropper concluded that the termination premium was a pre-petition ''claim'' within the meaning of the Bankruptcy Code, because it was a ''classic contingent claim.''[13] In reaching that conclusion, Judge Gropper interpreted the term ''claim'' very broadly, and relied, *inter alia*, on the cases holding that pension liabilities are contingent, pre-petition claims.[14] He also found it significant that there was no amendment to the Bankruptcy Code, which was amended just a few months prior to the enactment of the DRA, explicitly making the yet to be enacted termination premiums priority or nondischargeable claims under the Bankruptcy Code.[15]

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[4] 29 C.F.R. § 4007.13(a)(1)(ii).
[5] 29 U.S.C. § 1306(a)(7)(A).
[6] 29 U.S.C. § 1306(a)(7)(B).
[7] 29 U.S.C. § 1306(a)(7)(C).
[8] H.R. Rep. 109-276, at 348 (2005).
[9] Staff of Joint Comm. on Taxation, 109th Cong. Technical Explanation of H.R. 4, the ''Pension Protection Act of 2006,'' as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006.
[10] In bankruptcy parlance, a ''pre-negotiated'' bankruptcy—as opposed to a ''pre-packaged'' case—''involves pre-filing agreements with most, but not all, significant creditor constituencies. So while it is a ''quick dip,'' it is not as quick as a pre-pack.

[11] *See, e.g., In re Chateaugay Corp.*, 115 B.R. 760, 12 EBC 1441 (Bankr. S.D.N.Y. 1990), aff'd 130 B.R. 690, 14 EBC 1225 (S.D.N.Y. 1991) and *In re Chataeugay Corp.*, 126 B.R. 165, 13 EBC 1761 (Bankr. S.D.N.Y. 1991), opinions withdrawn and vacated on other grounds, 17 EBC 1102, 1993 WL388809 (S.D.N.Y. 1993); *In re Finley Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 160 B.R. 882, 17 EBC 2118 (Bankr. S.D.N.Y. 1993).
[12] *Oneida, Ltd. v. Pension Benefit Guaranty Corp.*, 372 B. R. 107, 41 EBC 2914 (S.D.N.Y. 2007)(141 PBD, 7/24/07; 34 BPR 1803, 7/31/07). *See also In re Ionosphere Clubs, Inc.*, 922 F.2d 984 (2d Cir. 1990); *PBGC v. Smith Corona Corp.*, 205 B.R. 712, 20 EBC 2312 (D. Del. 1996).
[13] *Oneida, Ltd. v. Pension Benefit Guaranty Corp.*, 383 B. R. 29, 43 EBC 1298 (Bankr. S.D.N.Y. 2008)(42 PBD, 3/4/08; 35 BPR 577, 3/11/08).
[14] *E.g., Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F. 2d 98 (2d Cir. 1986).
[15] 383 B.R. at 41, 43 EBC at 1305.

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Direct Appeal to Second Circuit

Ordinarily, appeals of orders of the bankruptcy court are heard by the district court, with a further appeal of right to the court of appeals. As a practical matter, this two-step appellate practice adds about a year of litigation to the process. PBGC and Oneida jointly sought permission, under 28 U.S.C. § 158(d)(2), to allow PBGC to appeal directly to the court of appeals on the grounds that the question presented ''involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or the Supreme Court of the United States, or involves a matter of public importance.'' That motion was granted,[16] and on April 8, 2009, the Second Circuit reversed the decision in favor of Oneida.

Writing for the three judge panel, U.S. District Court Judge Jed Rakoff, sitting by designation, literally made short shrift of Oneida's arguments and the decision below. Analyzing the plain language of the General Rule and Special Rule, as well as the legislative history of the termination premium, the panel concluded that Congress intended that the liability would not arise until after a reorganized employer has emerged from bankruptcy. To determine the nature of the claim at issue, the court looked to the substantive non-bankruptcy law that gave rise to the obligation:[17]

> Here, the substantive, non-bankruptcy law giving rise to Oneida's obligation to pay a Termination Premium is the Special Rule, which unambiguously states that where a pension plan is terminated in connection with an employer's bankruptcy reorganization, the General Rule '' which creates PBGC's right to a Termination Premium ''shall not apply to such plan until the date of the discharge or dismissal of [the employer]. . . The obvious purpose of this rule is to prevent employers from evading the Termination Premium while seeking reorganization in bankruptcy. . . . Congress may prescribe when a claim will be legally effective for the purposes of the Bankruptcy Code, at least where, as here, the non-bankruptcy statute explicitly discusses how the obligation should be treated in bankruptcy.[18]

[16] *Pension Benefit Guar. Corp. v. Oneida Ltd.*, No. 08-2964, 2009 U.S. App. LEXIS 7176 (2d Cir. April 8, 2009).

[17] Slip. Op. at 6; *see Travelers Cas. & Surety Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007); *Raleigh v. Ill. Dept. of Revenue*, 530 U.S. 15 (2000).

[18] Slip Op. at 6-7 (Emphasis in original).

The court of appeals continued and noted that what happened in the *Oneida* case

> 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.[19]

Noting no ambiguity in the statutory language, the Court nevertheless analyzed the legislative history of the DRA and PPA, and concluded that ''[t]reating the Special Rule as a pre-petition claim would . . . directly thwart Congress's aim in establishing the Special Rule.''[20]

Implications for the Future

At least until there is a split in the circuits—and there does not appear to be another test case in the pipeline—PBGC now has the upper hand regarding the termination premium. Thus, termination while in bankruptcy will become a more expensive option in the future, because the termination premium will have to be paid with real, post-bankruptcy dollars. In these circumstances, one would expect that PBGC will not be inclined to compromise on this issue, as it will not see much litigation risk. And if there is any doubt about the added expense, let's do some math. If it had been in ERISA when United Air Lines' four pension plans were terminated (still the largest PBGC takeover in history), the termination premium would have been almost $460 million! And, just to sharpen the point, with all the current discussion about possible bankruptcy filings in the automotive sector, the amount of the termination premium for General Motors would be about $2.5 billion. That's an effective deterrent. Presumably, this new expense will give serious pause to companies reorganizing in bankruptcy before going down the path to plan termination, and those companies may instead have to consider other strategies for dealing with the pension liabilities. The Second Circuit's ruling on this issue may also become one of the many factors considered when a company chooses venue in a bankruptcy case.

[19] Slip Op. at 7.

[20] Slip Op. at 8.