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Termination Premiums Payable to the PBGC Survive Chapter 11 Bankruptcy Proceedings

On April 8, 2009, the United States Court of Appeals for the Second Circuit overturned a bankruptcy court's decision regarding the treatment of the "termination premium" imposed on a sponsor of a pension plan that was involuntarily terminated by the Pension Benefit Guaranty Corporation ("PBGC"). This decision could have an important effect on debtors with defined benefit pension plans terminated during a chapter 11 bankruptcy proceeding.

The PBGC is the federal entity responsible for insuring the payment of promised retirement benefits under broad-based corporate pension plans. When an underfunded pension plan is terminated, the PBGC takes over administration of the plan and guarantees a certain minimum level of benefits to participants. Under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), when a defined benefit pension plan is terminated either by the PBGC in an involuntary termination or by the plan sponsor in a distress termination, the plan sponsor must pay a "termination premium" to the PBGC. The termination premium obligation was implemented as part of the Deficit Reduction Act of 2005 in an attempt to reduce the growing deficit in the PBGC's budget, and to make termination of underfunded plans less appealing to plan sponsors. The statute requires the sponsor of a plan terminated involuntarily or in a distress termination to pay $1,250 per year, per participant, for three years.[1] Payment of the premium generally begins in the first month following the month in which the plan termination occurs. However, when the plan is terminated in connection with a chapter 11 bankruptcy proceeding, the statute delays the payment obligation until the first month following the discharge of the debtor from bankruptcy.

Last year, the United States Bankruptcy Court for the Southern District of New York in *Oneida Ltd. v. Pension Benefit Guaranty Corp.* (*In re Oneida Ltd.*) addressed whether the duty to pay the termination premium payment could be considered a "claim" subject to compromise in a bankruptcy process. Within a chapter 11 restructuring proceeding, all "claims" against the debtor must be discharged by the bankruptcy court upon confirmation

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[1] This premium amount is doubled in the case of commercial passenger airline or airline catering services whose defined benefit plans are terminated during the first five years after the sponsor elects certain special funding rules.

of the debtor's plan of reorganization. The debtor argued that the obligation to pay the termination premium was a contingent "claim" under Section 101(5)(A) of the Bankruptcy Code. The court agreed, holding that the term "claim" is broadly defined in the Bankruptcy Code and that it includes contingent future rights to payment. The court further held that the obligation was properly characterized as a prepetition claim, and that it was therefore necessarily discharged upon confirmation of the debtor's plan of reorganization, releasing Oneida from any duty to pay the termination premium upon its emergence from bankruptcy, other than as an unsecured claim under the debtor's plan of reorganization.

The PBGC appealed the decision, and, on April 8, 2009, the Second Circuit Court of Appeals reversed the lower court's ruling. The Second Circuit held that the existence of a valid prepetition "claim" depends on whether the claimant possessed a right to payment, and whether that right arose before the filing of the petition; in the case of a termination premium arising in connection with a chapter 11 reorganization, the obligation to pay does not arise until the bankruptcy process is complete, and therefore could not be considered a "claim" within the process. The Second Circuit stated that "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." Further, the Court held that Congress' specific intent to preserve and delay payment of termination premiums in a bankruptcy reorganization must be respected and would trump other general standards contained in chapter 11 of the Bankruptcy Code.

The Second Circuit ruling is the first published decision on this issue, representing the opinion of a respected appellate court interpreting a statute that, in the Court's view, is unambiguous. While it is possible that other courts addressing the issue will disagree with the conclusion, debtors should be careful to consider the Second Circuit's ruling for two principal reasons.

First, a debtor that emerges from the reorganization process would, under the ruling, be liable for the full amount of the termination premium, which must be paid over the three years following approval of the plan of reorganization. The obligation may be significant in the context of the capitalization of the debtor upon emergence from bankruptcy.

Second, while ERISA contemplates that a debtor will not be liable for the termination premium until its emergence from bankruptcy, which is consistent with the Second Circuit's decision, regulations issued by the PBGC provide that all members of the controlled group *as of the day before the date of plan termination* are jointly and severally liable for the termination premium. The regulations therefore look back to a time when, under the statute and the *Oneida* ruling, the right to payment does not exist since the plan sponsor has not completed the bankruptcy process. In the context of a chapter 11 case, then, the PBGC may take the position that the members of a debtor's controlled group not subject to the bankruptcy proceedings (i.e., non-debtor subsidiaries) are immediately liable for such termination fees even though collection against the debtor is stayed. While that position seems inconsistent with the language of the statute and the Second Circuit's recent holding, debtors in chapter 11 cases need to be mindful of the potential controlled group liability. In particular, if the debtor contemplates asset sales or other divestures during the bankruptcy proceeding, the controlled group liability may pose issues for potential buyers.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Employee Benefits or Bankruptcy and Restructuring in the "Practices" section of our website (http://www.clearygottlieb.com) if you have any questions.

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