Premiums Payable To PBGC After Termination Not Dischargeable

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The Deficit Reduction Act (DRA) of 2005 was enacted on February 28, 2006. The DRA amended ERISA to require payment to the PBGC of a termination premium for defined benefit pension plans in or out of bankruptcy. The "Termination Premium" is designed to help insure employees against the nonpayment of pension benefits if the employer terminates a covered fund.

Pursuant to the provisions of the Deficit Reduction Act of 2005, $1,250 per participant is imposed for the year of termination and for each of the following two years. The termination premium is based on the number of participants in the plan immediately before the termination date. The termination premium does not apply to a distress termination based on liquidation in bankruptcy or insolvency proceedings but does apply to a distress termination based on any of the other distress criteria or to an involuntary termination. 29 U.S.C. § 1306(a)(7)(A).

Under the "General Rule," the termination premium must be paid within 30 days after the beginning of the first applicable plan year that such premium takes effect. 29 U.S.C. § 1306(a)(7)(C). For plans terminated "during the pendency of any bankruptcy reorganization proceeding under chapter 11," the "Special Rule" applies and the termination premium is not due until after the debtor is discharged from bankruptcy. 29 U.S.C. § 1306(a)(7)(B).

The goal of the Deficit Reduction Act of 2005 was to reform funding rules to ensure pensions were adequately and consistently funded, and increase premiums paid by employers to the PBGC. Before 2005, pension insurance programs administered by the PBGC had come under severe pressure due to unprecedented pension plan terminations, which were substantially underfunded. In 2004, PBGC's single employer insurance program posted losses totaling $14.7 billion, and ended with a deficit of $23.3 billion. To minimize the consequences to workers, retirees, and other employees, Congress believed that a termination premium for former plan sponsors who initiate and complete a distress termination while in bankruptcy is appropriate. Congress believed that sponsors who file a petition for bankruptcy reorganization must take into account the cost of the termination premium that will be impose subsequent to an emergence from bankruptcy.

PBGC v. Oneida

The United States Court of Appeals for the Second Circuit recently ruled that a company that terminates its defined benefit pension plan in a Chapter 11 case is liable to the PBGC for pension termination premiums after it emerges from a Chapter 11 reorganization. *PBGC v. Oneida Ltd.*, 562 F.3d 154 (2d Cir. 2009). This decision is the first appellate court decision applying the termination premium provisions that Congress enacted in the Deficit Reduction Act of 2005.

Oneida filed for Chapter 11 reorganization in 2006. Oneida's pension plans were underfunded by approximately $40 million. While in bankruptcy, Oneida terminated one of its single-employer defined benefit pension plans. Oneida agreed to provide PBGC with a $3 million promissory note for the terminated plan. After Oneida's reorganization plan was confirmed, Oneida sought a declaratory judgment from the Bankruptcy Court, Southern District of New York, that the applicable Termination Premium was an unsecured, pre-petition bankruptcy claim under Section 101(5) of the Bankruptcy Code.

The bankruptcy court believed that the Termination Premiums were dischargeable pre-petition claims because of the broad definition accorded the term "claim" in the bankruptcy context. The Bankruptcy Code defines "claim" as 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." Applying an expansive definition of "claim," the bankruptcy court held that the termination premiums were contingent, pre-petition claims that could be discharged in a bankruptcy proceeding. The bankruptcy court concluded that the termination premium was a "classic contingent claim" because any obligation to pay the PBGC could not arise unless a pension plan was terminated by a debtor during its bankruptcy. The bankruptcy court also concluded that the PBGC's claim arose prepetition. The Second Circuit permitted a direct appeal and reversed.

The Second Circuit agreed that the term "claim" should have wide scope, but noted that the definition's reach is "not infinite." Rather, "the existence of a valid bankruptcy claim depends on (1) whether the claimant possessed a right to payment, and (2) whether that right arose before the filing of the petition." In order to make these determinations, the court must look to the substantive non-bankruptcy law that gives rise to the debtor's obligation

The Second Circuit looked to the "Special Rule" as the applicable non-bankruptcy law and concluded that an employer's obligation to pay a Termination Premium to the PBGC on a pension plan that is terminated during the course of the bankruptcy does not even arise until the bankruptcy itself is terminated. The Court noted that although in the context of a private contract, the language might not control the question of whether a "claim" existed, Congress may prescribe when a claim will be legally effective for the purposes of the Bankruptcy Code, at least, where the "non-bankruptcy statute *explicitly* discusses how the obligation should be treated in bankruptcy." This is consistent with the legislative history of the DRA, which explains that the Termination Premiums were established in response to increasing financial pressure on the PBGC as a result of a rise in number of pension plan terminations. Congress specifically recognized that the Termination Premium could be jeopardized by the bankruptcy protection and as a result, created the Special Rule. The House Committee specifically stated:

> [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.

Impact of the *Oneida* Decision

This decision is the first appellate court decision to address the termination premiums. It is likely that other courts will follow the Second Circuit's lead on this issue. Companies will have to demonstrate the ability to pay the termination premiums in order to confirm a plan of reorganization. This may prevent companies from reorganizing, and in any event reduce the dividend to general creditors.

The Bankruptcy Court in *Oneida* suggested that the termination premium would not apply if a debtor liquidated in chapter 11. The PBGC has asserted claims for the termination premium in liquidating chapter 11 cases. The PBGC asserted a claim in the *USA Commercial Mortgage* bankruptcy, arguing that the termination premium is entitled to administrative priority as a tax in a liquidating chapter 11. The bankruptcy court concluded that since the debtor was not discharged and the termination premium did not become due until discharge, the claim never arose. The bankruptcy court rejected the PBGC's claim.

This decision makes sense in light of the fact that there were no ongoing operations. It is also consistent with congressional intent, since the legislative history indicates that "[t]he premium would not apply to firms that are liquidated by a bankruptcy court."

Conclusion

The *Oneida* decision did not change the priority of the PBGC's unfunded benefit or minimum funding claims. With an increasing number of significantly underfunded pension plans, the PBGC will continue to be a large unsecured creditor in many bankruptcies. Under *Oneida*, however, the PBGC may also have a large post-confirmation claim. This claim may present a serious obstacle in confirming a plan of reorganization.

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