



Restructuring and Insolvency Practice

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Second Circuit Rules Debtors Must Pay Substantial Pension Termination Fees

In a recent reversal of a Bankruptcy Court decision, the U.S. Court of Appeals for the Second Circuit upheld a law which could further burden financially distressed companies attempting to reorganize and exit bankruptcy. The Second Circuit ruled that “termination premiums” owed to the Pension Benefit Guarantee Corp. (“PBGC”) are not pre-petition claims which may be discharged under the Bankruptcy Code.

Oneida Ltd., a flatware designer and manufacturer, filed a chapter 11 bankruptcy petition and terminated one of its single-employer, defined-benefit pension plans pursuant to a stipulation which preserved the PBGC’s right to seek to enforce payment of termination premiums. Generally, under federal labor law, an employer that terminates a pension plan is obligated to pay the PBGC \$1,250 per plan participant per year, for three years, beginning the first month following termination of the pension plan. For terminations which occur during bankruptcy, there is a “Special Rule,” under which this obligation does not commence until the first month following the debtor’s discharge or dismissal from bankruptcy.

Under Section 1141 of the Bankruptcy Code, the confirmation of a bankruptcy plan will generally discharge a debtor of all debts that arose prior to confirmation. In Oneida’s bankruptcy, the Bankruptcy Court for the Southern District of New York initially held that the termination premiums were claims which arose pre-petition, and could be discharged. Applying a broad definition to the term “claim,” the Bankruptcy Court found that the termination premiums arising under the Special Rule were contingent claims which had been created prior to the bankruptcy filing.

In reversing the Bankruptcy Court, the Second Circuit looked first to the text of the labor statute and found it “apparent from the face of the [statute]” that the liability for the termination premium does not arise until the date that the debtor/employer is discharged from bankruptcy proceedings. The statute “unambiguously states that where a pension plan is terminated in connection with an employer’s bankruptcy reorganization,” then the Special Rule applies, and thus the obligations due to the PBGC do not arise pre-petition; rather, the obligations only arise at plan confirmation and discharge from bankruptcy.

Arguing further from legislative history, the Second Circuit found that Congressional records resolved any ambiguity in the PBGC’s favor. Termination premiums were established in 2005 in response to an increase in pension plan terminations which had pressured the PBGC. To avoid having its efforts to bolster the PBGC hamstrung by employers seeking protection in bankruptcy, Congress enacted the Special Rule to avoid any doubt that the termination payments were intended to arise after the date the bankruptcy petition was filed. To hold otherwise, said the Second Circuit, would “directly thwart Congress’s aim in establishing the Special Rule.”

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Having determined that the termination premiums do not arise pre-petition, the Second Circuit remanded the case to the Bankruptcy Court, where, presumably, Oneida would be forced to amend its plan of reorganization to accommodate the termination premiums.

Assuming the Second Circuit's decision is not overturned by the Supreme Court (which is unlikely), this decision sets a significant precedent for holding employers liable to the PBGC for termination premiums, and may have substantial ramifications for major union employers seeking to terminate pension plans during the course of bankruptcy proceedings.

If you have any questions concerning the items in this Briefing, or about restructuring and insolvency matters generally, please contact one of the following attorneys:

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