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Client Advisory: Second Circuit Finds Termination Premiums Not Dischargeable "Claims" in Bankruptcy

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On April 8, 2009, the United States Court of Appeals for the Second Circuit found that "termination premiums" due under Section 4006(a)(7) of the Employee Retirement Income Security Act ("ERISA") are not "claims" under the Bankruptcy Code and are therefore not dischargeable in bankruptcy.[1] This decision has a substantial impact on any company considering a Chapter 11 bankruptcy proceeding as a means to eliminate pension obligations.

Under normal circumstances, the Pension Benefit Guaranty Corp. ("PBGC") collects "termination premiums" from entities that terminate their pension plans in certain distress terminations. These payments help to insure employees against the non-payment of pension benefits. Upon termination of a pension plan, ERISA requires the employer to pay $1,250 per covered individual who participated in the plan immediately prior to its termination for each of the next three 12-month periods beginning thereafter. A so-called "Special Rule" applies to employers in bankruptcy reorganization proceedings, which provides that the termination premiums begin to accrue on the date of the discharge or dismissal of the employer's bankruptcy case.

In March 2006, Oneida Ltd., a designer and manufacturer of flatware, filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code. During its bankruptcy proceedings, Oneida terminated one of its single-employer, defined-benefit plans. After confirming a plan of reorganization, Oneida commenced an action against PBGC seeking a declaratory judgment that the PBGC's claims for termination premiums were "contingent pre-petition claims" that had been discharged by Oneida's plan of reorganization. The PBGC argued in response that the termination premiums did not fall into the definition of "claim" set forth in Section 101 of the Bankruptcy Code. Because the termination premiums were not "claims," PBGC indicated, they were not subject to discharge.

1 See generally *Pension Benefit Guaranty Corp. v. Oneida, Ltd.*, No. 08-2964-bk (2d Cir. Apr. 8, 2009).

The Bankruptcy Court for the Southern District of New York sided with Oneida.[2] The court indicated that the term "claim" in the Bankruptcy Code is intended to have "the broadest available definition."[3] The court noted that the term includes rights to payment that are "contingent" and "unmatured." Thus, the fact that a right to payment is subject to one or more contingencies, such as a pension plan termination or a Chapter 11 discharge, does not remove the right to payment from the definition of "claim." The court found that, based on the language of ERISA, the termination premiums were "classic contingent claim[s]." The court was unconvinced by the PBGC's arguments, largely because pension liabilities have frequently been held to be "claims" within the definition of the Bankruptcy Code.[4] Moreover, the court indicated, the PBGC's argument would permit parties to circumvent a bankruptcy discharge for any claim simply by providing in their contract that a cause of action does not "arise" until after confirmation. Furthermore, the court found that the language of ERISA did not indicate any congressional intent to amend the Bankruptcy Code to account for payment of termination premiums.

The parties framed the issue as whether the termination premiums constituted pre-petition claims or post-petition claims. PBGC argued that the claims were post-petition because they did not become enforceable until Oneida's distress termination of its pension plan, which occurred post-petition. In response, Oneida argued that the claim was merely a contingent pre-petition claim that matured during bankruptcy. In siding with Oneida, the court relied on Second Circuit precedents on indemnification and environmental liabilities. The court indicated that the claim dates back to the commencement of the relationship between the parties, not when the cause of action arose. Because the statute mandated these payments before Oneida filed its petition, the court held that the termination premium claims were pre-petition contingent claims.

On appeal,[5] the Second Circuit reversed. The court noted that the bankruptcy court had read the definition of "claim" too broadly, indicating that the provision's reach is "not infinite." The court found that the substantive, non-bankruptcy law giving rise to Oneida's obligation to pay the termination premium was the Special Rule in ERISA. The "obvious purpose" of this rule is to prevent employers from evading termination premiums while seeking reorganization in bankruptcy. The court found that the Special Rule "explicitly discusses" how the obligation should be treated in bankruptcy. Because the employer's obligation to pay a termination premium does not even arise until the bankruptcy itself is terminated, the court found that the term "claim" cannot "extend to a right to payment that does not yet exist under federal law." Furthermore, legislative history suggests that ambiguity should be read in the PBGC's favor and that treating the Special Rule's termination premium as a pre-petition claim would "directly thwart Congress's aim in establishing the Special Rule." Consequently, the Second Circuit reversed the bankruptcy court's decision and remanded for further proceedings consistent with its ruling.

Unless Oneida appeals or the parties otherwise settle, the bankruptcy court will address the issue on remand. To be consistent with the Second Circuit ruling, the bankruptcy court will most likely conclude that termination premiums are to be treated as post-petition priority claims, payable in full by Oneida as

2 See *In re Oneida Ltd.*, 383 B.R. 29 (Bankr. S.D.N.Y. 2008), *rev'd, Pension Benefit Guaranty Corp. v. Oneida, Ltd.,* No. 08-2964-bk (2d Cir. Apr. 8, 2009).

3 *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991).

4 See *Oneida*, 383 B.R. at 39 (citing, e.g., *Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 103-04 (2d Cir. 1986) (withdrawal liability is not an administrative expense but a prepetition claim); *In re Art Shirt Ltd., Inc.*, 93 B.R. 333, 338 (E.D. Pa. 1988) (withdrawal liability considered a debt for purposes of determining insolvency).

5 The parties bypassed appeal to the District Court based on 28 U.S.C. § 158(d)(2), which grants jurisdiction to the Court of Appeals to hear an appeal when 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 of the Supreme Court of the United States, or involves a matter of public importance."

administrative expenses of the bankruptcy estate. If the Second Circuit ruling stands and is followed in other jurisdictions, companies will have to reassess the viability of using bankruptcy as a means to discharge pension obligations. The Second Circuit decision raises questions for companies that cannot successfully reorganize without both terminating pension obligations and eliminating onerous premiums. In light of this decision, companies developing a restructuring plan must now account for termination premiums rather than rely on the prospect of discharge.

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