



# Employee Benefits in Bankruptcy Committee

## ABI Committee News

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### PBGC Termination Premium: the Bankruptcy Code vs. ERISA

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In 2006, Congress amended the Employee Retirement Income Security Act of 1974 (ERISA) to add a termination premium to be paid to the Pension Benefit Guaranty Corporation (PBGC) in certain situations when the PBGC took over an underfunded defined benefit plan.<sup>[1]</sup> For a plan terminated "during the pendency of any bankruptcy reorganization proceeding under chapter 11," the termination premium is due only after the debtor is discharged from bankruptcy.<sup>[2]</sup> As yet there are few decisions interpreting the interplay between the termination premium and the Bankruptcy Code.

The Second Circuit recently agreed to hear a direct appeal of the bankruptcy court decision in *Oneida Ltd. v. PBGC (In re Oneida Ltd.)*,<sup>[3]</sup> the first case to test whether the due date made the termination premium a postpetition claim. In *Oneida*, the bankruptcy court held that the termination premium claim arose prepetition and therefore was discharged by Oneida's plan of reorganization. Meanwhile, the bankruptcy court in *USA Commercial Mortgage*<sup>[4]</sup> concluded that PBGC had no claim in a liquidating chapter 11 case.

#### Termination Premium under ERISA

The termination premium is due as a result of the termination of an underfunded defined benefit plan. The termination premium is \$1,250 per participant for each of the three years after the plan is terminated.<sup>[5]</sup> For plans terminated while the sponsor or member of the controlled group is in bankruptcy reorganization or similar state proceeding, the first payment is due in each of the three years after the date of

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discharge.<sup>[6]</sup>

Whether a termination premium is due under the statute depends on the reason that the underfunded plan was terminated. An underfunded pension plan may be terminated by the plan administrator or by PBGC. If the plan is underfunded, an administrator may seek a distress termination only if each member of the sponsor's controlled group can meet one of the following distress criteria:

1. liquidation in bankruptcy or insolvency proceedings;
2. reorganization in bankruptcy or other insolvency proceedings, with the court finding that the reorganization cannot succeed unless the plan is terminated;
3. PBGC determination that there is an inability to pay debts when due and an inability to continue in business unless the plan is terminated; or
4. PBGC's determination that pension costs have become unreasonably burdensome due solely to a declining workforce.<sup>[7]</sup>

Members of the controlled group may satisfy different distress criteria.

The termination premium does not apply to a distress termination based on the liquidation in bankruptcy or insolvency proceedings but does apply to a distress termination based on any of the other three distress criteria or to an involuntary termination initiated by the PBGC.<sup>[8]</sup> Unless all members of the controlled group are liquidating in bankruptcy or insolvency proceedings, the PBGC has taken the position that the termination premium applies and that all members of the controlled group are liable.<sup>[9]</sup> PBGC has also taken the position that the due date for the termination premium is accelerated if a bankruptcy reorganization is converted to a liquidation.<sup>[10]</sup>

### **Claims under the Bankruptcy Code**

PBGC originally sought to have the reference withdrawn so that the issue could be decided by the district court. However, the district court declined to do so, concluding that a resolution of the issue would require the bankruptcy court "to do what it does on a routine basis: determine whether the [termination premiums] are postpetition obligations that must be paid by Oneida upon reorganization, or prepetition 'claims' that may be discharged pursuant to the Plan of Reorganization."<sup>[11]</sup> Thus the key questions were whether the termination premiums were claims and whether they arose prepetition.

The Bankruptcy Code defines the term "claim" broadly as a "right to payment, whether such right is reduced to judgment, liquidated, unliquidated, fixed,

contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured."<sup>[12]</sup> The bankruptcy court easily concluded that the termination premium was a claim for purposes of the Bankruptcy Code: "the fact that a right to payment is subject to one or more contingencies, such as pension plan termination or a chapter 11 discharge, does not remove the right to payment from the definition of 'claim.' "<sup>[13]</sup>

The court noted that the statute creating the termination premium did not amend the Bankruptcy Code or make the termination premium nondischargeable, as Congress had done domestic support obligations, pension plan loans and certain other debts when it enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).<sup>[14]</sup> While ERISA generally preempts state law, there is no similar preemption of other federal laws such as the Bankruptcy Code.<sup>[15]</sup>

The key question presented in *Oneida* was whether the fact that the termination premium is not due until the debtor is discharged causes it to be a postpetition claim. There appears to be no question that the pension liabilities itself were prepetition claims. Courts that have considered the question have uniformly concluded that contingent pension obligations triggered by a termination during the bankruptcy are prepetition contingent claims to the extent that the underlying pension obligation accrued pre-petition.<sup>[16]</sup> The bankruptcy court in *Oneida* concluded that the termination premium, triggered by the same termination event, was also a prepetition claim.<sup>[17]</sup> The termination premium was enacted prior to the bankruptcy filing and therefore distinguishable from cases in which statutory liability, as contrasted to the due date for payment, arose after confirmation.<sup>[18]</sup> The court reconciled ERISA and the Bankruptcy Code by concluding that PBGC had an unsecured claim for the termination premium.

### **Liquidating Chapter 11**

The *Oneida* court assumed that the termination premium would not apply if a debtor liquidated in chapter 11.<sup>[19]</sup> PBGC has asserted claims for the termination premium in liquidating chapter 11 cases. PBGC asserted a claim in the *USA Commercial Mortgage*<sup>[20]</sup> bankruptcy, arguing that the termination premium is entitled to administrative priority (as a tax) in a liquidating chapter 11. The bankruptcy court in that case concluded that there was no claim and disallowed PBGC's claim.<sup>[21]</sup> Since the debtor was not discharged and the termination premium did not become due until discharge, the court concluded that the claim never arose. <sup>[22]</sup> PBGC's claim for the termination premium in liquidation cases would seem to undercut PBGC's position that the termination premium is not a "claim" for purposes of the Bankruptcy Code.

PBGC asserted the claim in *USA Commercial Mortgage* even though the debtor was liquidating because the plan had terminated in an involuntary termination. While Congress specifically excluded liquidation in bankruptcy as a distress termination event that would trigger the termination premium, PBGC argued that there is no similar exception when PBGC initiates an involuntary termination. (The debtor in *USA Commercial Mortgage* had not sought a distress termination.) PBGC's claim would appear to be inconsistent with congressional intent, since the legislative history indicates that "[t]he premium would not apply to firms that are liquidated by a bankruptcy court."<sup>[23]</sup> The bankruptcy court's opinion in *USA Commercial Mortgage* achieved the result intended by Congress albeit by a different route than that suggested by the legislative history.

The impact could be significant. Revenue estimates when Congress was considering the termination premium indicated that this provision would raise over \$1 billion in fiscal years 2006 through 2010. However, this hypothesis is based on the following key assumption: "Based on recent PBGC data on terminations, CBO estimates that underfunded plans that will be terminated over the next five years would contain about 120,000 participants per year, *with three-quarters of these terminations relating to nonliquidation bankruptcy filings.*"<sup>[24]</sup> CBO apparently assumed that companies that file under chapter 11 usually reorganize. However, most companies that file for chapter 11 end up liquidating, with their assets sold to one or more acquirers. Seven of the 10 largest claims in the PBGC's history at the time the termination premium passed related to chapter 11 debtors that liquidated.

### **Conclusion**

The drafters of the termination premium provisions were clearly trying to make an end run around the Bankruptcy Code because they were unable to convince the judiciary committees to amend the Code to create an exception to the "fresh start" principle that underlies bankruptcy reorganization. Similar attempts in PBGC-related legislation in the past have not met with success. The question for the Second Circuit in *Oneida* is whether this end run will be successful.

Even if PBGC is successful in its arguments that ERISA trumps the Bankruptcy Code, there will be many cases in which the debtor cannot reorganize if it must pay the full termination premium. Although PBGC declined to adopt a policy of routinely settling termination premium claims for less than full value, PBGC has signaled its willingness to negotiate such settlements in appropriate cases.<sup>[25]</sup> Only time will tell how much of the \$1 billion will materialize.

1. ERISA §4006(a)(7), 29 U.S.C. §1306(a)(7), added by §8101(b) of the Deficit Reduction Act of 2005, Pub. L. 109-171, 120 Stat. 180 (Feb. 8, 2006).
2. ERISA §4006(a)(7)(B), 29 U.S.C. §1306(a)(7)(B).
3. 383 B.R. 29 (Bankr. S.D.N.Y. 2008). Pursuant to a scheduling order entered on Sept. 9, 2008, briefing is to be complete on or before Nov. 24, 2008. See *PBGC v. Oneida Ltd. (In re Oneida Ltd.)*, Case No. 08-2964-mb (2d Cir.).
4. Case No. 06-10725-lbr (Bankr. D. Nev. April 13, 2006).
5. See ERISA §4006(a)(7)(A), 29 U.S.C. §1306(a)(7)(A).
6. See ERISA §4006(a)(7)(B), (C)(ii), 29 U.S.C. §1306(a)(7)(B), (C)(ii).
7. See ERISA §4041(b), (c)(2)(B), 29 U.S.C. §§1341(b), (c)(2)(B).
8. ERISA §4006(a)(7)(A), 29 U.S.C. §1306(a)(7)(A).
9. See 29 C.F.R. §4007.13(a)(ii); regulation preamble at 72 Fed. Reg. 71222, 71224-25 (Dec. 17, 2007) (PBGC Preamble).
10. See PBGC Preamble, 72 Fed. Reg. at 71226.
11. *Oneida Ltd. v. PBGC*, 372 B.R. 107, 111 (S.D.N.Y. 2007).
12. 11 U.S.C. §101(5)(A).
13. 383 B.R. at 37. For a discussion of this issue from the PBGC perspective, see James L. Eggeman and Erika E. Barnes, "Is ERISA's New Premium for Pension Plans Terminated in Chapter 11 a Claim under the Bankruptcy Code §101(5)?," *ABI Employee Benefits in Bankr. Comm. Newsletter*, Vol. 2, Issue 3 (October 2007).
14. 383 B.R. at 41, n. 14.
15. See ERISA §514(a), 29 U.S.C. §1144(a).
16. See, e.g., *PBGC v. CF&I Fabricators of Utah Inc. (In re CF&I Fabricators of Utah Inc.)*, 150 F.3d 1293, 1300 (10th Cir.1998), *cert. denied*, 119 S. Ct. 2020 (1999); *PBGC v. Sunarhauserman Inc. (In re Sunarhauserman Inc.)*, 126 F.3d 811, 817-19 (6th Cir. 1997). In the case of Oneida's pension plan, all accruals had ceased two years prior to the bankruptcy filing.
17. 383 B.R. at 43-45.
18. 383 B.R. at 43-44 (distinguishing *LTV Steel Co. v. Shalala (In re Chateaugay*

*Corp.*), 53 F.3d 478, 497 (2d Cir.1995) (legislation enacted six years after bankruptcy filing)).

19. 383 B.R. at 39, n. 8.  
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20. Case No. 06-10725-lbr (Bankr. D. Nev. April 13, 2006).  
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21. Order Disallowing Amended Claim No. 791 (Bankr. D. Nev. July 18, 2008)  
[Docket No. 6523].  
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22. Tr. of 4/17/08 Hrg. on Obj. to PBGC Claim at 62-66 [Docket No. 6364-4, Ex. C].  
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23. H.R. Rep. No. 109-276, at 75 (2005).  
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24. *Id.* at 77 (emphasis added).  
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25. See PBGC Preamble, 72 Fed. Reg. at 71227.  
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