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Second Circuit Finds Termination Premiums Non-Dischargeable in Bankruptcy

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On April 8, 2009, the United States Court of Appeals for the Second Circuit, reversing a ruling by the United States Bankruptcy Court for the Southern District of New York, concluded that certain “termination premiums” due to the Pension Benefit Guaranty Corporation (“PBGC”) are not contingent pre-petition claims subject to discharge in a Chapter 11 reorganization. The Second Circuit’s decision is of great import because debtors that terminate their pension plans after filing for bankruptcy may no longer be able to escape paying significant claims to the PBGC.

Background

On February 28, 2006, the Deficit Reduction Act of 2005 (“DRA”) was enacted. The DRA requires employers that terminate qualified pension plans to pay annual “termination premiums” to the PBGC equal to \$1,250 per beneficiary for three years after the termination. A “Special Rule,” however, applies to termination of pension plans in bankruptcy proceedings. That “Special Rule” provides that termination premiums begin to accrue on the date of the discharge or dismissal of the employer’s bankruptcy case.

Flatware manufacturer Oneida Ltd. commenced a Chapter 11 case in 2006. At the outset of its case, Oneida moved to terminate its three underfunded pension plans. After confirming its plan of reorganization, Oneida sought a declaratory judgment that the PBGC’s claims for termination premiums were contingent pre-petition claims that were discharged by Oneida’s plan of reorganization. The Bankruptcy Court for the Southern District of New York agreed with Oneida. The PBGC

appealed the Bankruptcy Court's ruling and the Second Circuit granted the parties' joint request to hear the appeal directly under 28 U.S.C. § 158(d)(2).

The Second Circuit's Decision

The Second Circuit reversed the lower court's ruling. The Second Circuit stated that in order to have a valid bankruptcy claim, a party must have a right to payment that arose pre-petition, which right must be determined in accordance with non-bankruptcy law. The Second Circuit, relying on the "Specific Rule," found that the PBGC's right to payment of termination premiums does not arise until after the employer is discharged from bankruptcy. As such, the Second Circuit held that the PBGC's termination premium claim is not a pre-petition claim subject to discharge in Chapter 11. The Second Circuit remanded the case to the Bankruptcy Court for further proceedings consistent with its ruling.

Conclusion

The Oneida ruling is the first published decision on the issue. Companies seeking to use the bankruptcy process to terminate their pension obligations must now squarely address whether termination should occur before the bankruptcy filing in view of the Oneida ruling. This decision cannot be taken lightly as pre-petition pension plan termination might adversely impact a company's relationship with its employees.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North

25 Main Street

Hackensack, NJ 07601

Phone:

(201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone:
(212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone:
(302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone:
(410) 230-0660