

ALERT



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Pension Termination Premium Is Prepetition Unsecured Claim

Seeking to mitigate Pension Benefit Guaranty Corporation's ("PBGC") multi-billion dollar deficit, Congress enacted and the President signed into law the Deficit Reduction Act of 2005, which provided for certain modifications to the Employee Retirement Income Security Act of 1974 ("ERISA"). Among the Deficit Reduction Act's more significant provisions was the imposition of a premium — in other words, a penalty — for pension plans terminated as part of an in- or out-of-court restructuring. When a company terminates its pension plan while in chapter 11, the pension termination premium is \$1,250 per plan participant, payable every year for three years after the debtor's exit from bankruptcy. (When a company terminates a pension plan in an out-of-court restructuring, the premium is payable every year for three years after the date the plan was terminated). The pension termination premium was made permanent pursuant to the Pension Protection Act of 2006.

In the first case to address the treatment and level of priority of the new pension termination premium in the bankruptcy context, the United States Bankruptcy Court for the Southern District of New York recently held that the pension termination premium is a prepetition unsecured claim subject to discharge in a chapter 11 case. *In re Oneida Ltd.*, 2008 WL 516493, at *13 (Bankr. S.D.N.Y. Feb. 27, 2008).

In *Oneida*, the debtor terminated one of its defined benefit pension plans in a voluntary distress termination pursuant to section 4041 of ERISA, 29 U.S.C. § 1341, thereby triggering the pension termination premium. The debtor sought a declaratory judgment that PBGC's pension termination premium is a prepetition unsecured claim entitled to the same level of priority as all other general unsecured claims in the case. PBGC argued in response that the pension termination premium is not a "claim" subject to discharge under the Bankruptcy Code because the obligation to pay the premium does not become enforceable prior to the effective date of the discharge; therefore, the premium must be paid in full. PBGC also argued that even if the pension termination premium is a "claim," the termination premium arises postpetition and, therefore, is entitled to administrative expense priority under the Bankruptcy Code, which must be paid in full and ahead of unsecured claims.

The bankruptcy court rejected both of PBGC's arguments. First, the bankruptcy court determined that the pension termination premium in a chapter 11 case "is a classic contingent claim" that "becomes enforceable only after the debtor receives a discharge or the court case is dismissed." *Id.* at *6. The bankruptcy court recognized that excluding claims that arise *after* the effective date of the discharge from the Bankruptcy Code's definition of "claim" "would permit parties to a contract to create a new priority for themselves and circumvent the provisions of the

Bankruptcy Code by the simple expedient of providing that the debt did not accrue until after bankruptcy proceedings had terminated.” *Id.* at *7. The bankruptcy court also observed that PBGC’s position effectively would require the bankruptcy court to conclude that Congress implicitly amended the Bankruptcy Code to create a new exemption from the chapter 11 discharge. However, there is a presumption against implied amendment or repeal of the Bankruptcy Code, especially where the basis for such an implication is an appropriations bill. *Id.* at *8. Moreover, it is particularly telling that Congress recently amended the Bankruptcy Code to include additional exemptions from the discharge, but did not create an exemption for the pension termination premium. As a result, the bankruptcy court concluded that the pension termination premium is a “claim” subject to discharge in chapter 11.

Second, the bankruptcy court held that the pension termination premium is a *prepetition* claim not entitled to administrative expense priority under the Bankruptcy Code. *Id.* at *11. “When a right to payment is created by a statutory obligation, the counterpart ‘claim’ dates from the time of commencement of the relationship between the

parties, not the date when the right to payment became enforceable.” *Id.* at *10. The bankruptcy court found that all of the relevant facts supported a finding that the pension termination premium was contemplated between the debtor and PBGC prior to the chapter 11 filing, including the fact that the Deficit Reduction Act was passed before the debtor filed its chapter 11 petition and the debtor met with PBGC prior to the chapter 11 filing to discuss the possibility of termination and the treatment of PBGC’s claims in chapter 11.

The effect of the *Oneida* bankruptcy court’s holding that the pension termination premium is a prepetition unsecured claim will play out over the coming months. PBGC has appealed the bankruptcy court’s decision to the United States District Court for the Southern District of New York. In addition, PBGC likely will argue in other bankruptcy cases that the *Oneida* bankruptcy court erred in its application of the Bankruptcy Code’s priority scheme to the pension termination premium. Finally, PBGC may continue lobbying Congress for additional relief in the form of amendments to the Bankruptcy Code to clarify the priority status of pension termination premiums in chapter 11.

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