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WEATHERING THE STORM Recent Decision Creates Additional Cash Requirements to Reorganize

On April 8, 2009, the Second Circuit Court of Appeals issued a ruling that creates an additional hurdle for companies providing single-employer pension funds when seeking to reorganize through a bankruptcy. In general, the termination of a pension plan can give rise to a per-employee termination premium (a "Termination Premium") owed by the company terminating the plan to the Pension Benefit Guaranty Corporation ("PBGC"), the quasi-governmental entity that insures pension plans. In the past, when a debtor terminated a pension plan during its bankruptcy case, this Termination Premium was treated as a general unsecured claim to be satisfied as part of the plan of reorganization on a pro rata (typically *de minimis*) basis with all other unsecured claims. The Second Circuit's decision has called the legality of this practice into question and the decision will foist an additional, and in certain instances, significant cash requirement on companies seeking to reorganize, which may cause companies to skip reorganization and go directly to liquidation.

The Oneida Decision

In *Pension Benefit Guaranty Corp. v. Oneida, Ltd.*, 2009 WL 929528 (2d Cir. April 8, 2009), Oneida, the debtor designer and manufacturer of flatware, terminated a single-employer, defined-benefit pension plan. Litigation ensued between Oneida and the PBGC as to whether a \$1,250 per-employee Termination Premium was a general unsecured claim to be discharged by the bankruptcy, or an obligation required to be satisfied in cash as a prerequisite to Oneida's reorganization and confirmation of its plan.

The Bankruptcy Court for the Southern District of New York held (383 B.R. 29 (Bankr. S.D.N.Y. Feb. 27, 2008)) that the Termination Premium was a classic contingent claim which arose before Oneida filed for bankruptcy and, as such, should be treated as a general unsecured claim, dischargeable in Oneida's bankruptcy. In rejecting the PBGC's argument that the governing federal statute, 29 U.S.C. § 1306(a)(7)(B), specifically provides a Termination Premium in bankruptcy only arises when a debtor emerges from bankruptcy, the Bankruptcy Court pointed to Congress's expansive view of "claim;" as defined in section 101(5) of the Bankruptcy Code, *i.e.*, claim includes every contingent claim whether right to payment on such claim can be invoked.

In reversing the Bankruptcy Court, the Second Circuit Court of Appeals rejected the Bankruptcy Court's characterization of the Termination Premium as a "contingent claim" and agreed with the PBGC that Congress explicitly prescribed in 29 U.S.C. § 1306(a)(7)(B) that a Termination Premium claim only arises (*i.e.*, becomes legally effective) when the debtor emerges from bankruptcy. The Court of Appeals opined that the obvious purpose of this statute is to prevent employers from evading the Termination Premium while seeking the benefits of reorganization in bankruptcy.

The Straw that Breaks the Camel's back?

The *Oneida* decision creates yet another obligation that must be satisfied in cash as a condition to confirmation of a plan of reorganization in bankruptcy.

Since Congress's Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amendment of the Bankruptcy Code, bankrupt companies have been forced to satisfy certain, in some instances, significant claims in cash before exiting bankruptcy. Companies that cannot raise the cash to satisfy such claims either liquidate rather than reorganizing, or use liquidation as a threat to effectuate a reorganization.

Operating in perhaps the most unpredictable and tumultuous economic period in recent history, companies seeking bankruptcy financing, whether it be debtor-in-possession or exit financing, must pay exorbitant interest rates and fees unless they are able to secure defensive financing from existing equity sponsors or lenders. Companies either unable to, or unwilling to chance their ability to, secure financing to get the company through a reorganization, either liquidate or coerce their lenders into restructuring out of bankruptcy. The existence of additional cash obligations to effectuate a bankruptcy reorganization further restricts companies who need bankruptcy relief from reorganizing as Congress intended.

Secured Creditor Implications

The *Oneida* decision is even more troubling from a secured lender standpoint. Depending on where the fulcrum security lies, secured lenders of all varieties are having their recoveries/collateral carved up to appease administrative claimants, employees and unsecured creditors' committees that relentlessly attack secured lenders for taking all/too much of the reorganized company's value. The *Oneida* decision merely moves one more creditor constituency to the front of the line.

Conclusion

The Court in *Oneida* made a technical ruling that likely could have gone either way. The practical effect of the ruling, however, may have long-range, unintended implications on the bankruptcy world. The Southern District of New York has long been one of the favored jurisdictions for large corporate restructurings. As is with most untested decisions in a particular jurisdiction, companies that want to circumvent the effects of the *Oneida* decision may avoid filing their bankruptcy cases in New York, especially if they intend to terminate significant pension plans in bankruptcy. Given that we are on the precipice of three potentially mammoth auto manufacturer bankruptcies with implicated pension plan termination issues, this decision will resonate with the potential debtors and will cause companies to consider this additional hurdle when deciding whether and where to file for bankruptcy relief.

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