

Court Sides with Debtors in Disputed Distress Termination of Defined Benefit Plans

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Over the objection of PBGC, the U.S. Bankruptcy Court for the Eastern District of Missouri issued an opinion on October 26, 2005 finding that Falcon Products, Inc. and related debtors met the standard for reorganization distress termination of three defined benefit pension plans. *In re Falcon Products, Inc.*, No. 05-41108-399 (Bankr. E.D. Mo. Oct. 26, 2005). A debtor meets the reorganization distress test if the bankruptcy court concludes that, unless the pension plan is terminated, the debtor will be unable to pay all its debts pursuant to a plan of reorganizations and will be unable to continue in business outside the chapter 11 reorganization process. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV). The *Falcon* opinion is significant in four ways.

First, the court applied the test to the three plans in the aggregate, rather than on a plan-by-plan basis. Thus, even though the debtors could afford to make contributions to two of the plans based on projected cash flow, the court approved termination of all of the plans. The court, relying on *In re Kaiser Aluminum Corp.*, 2005 WL 735551 (D. Del. March 30, 2005), *appeal docketed*, No. 05-2695 (3d Cir. 2005), reasoned that the reorganization distress test should be read in concert with section 1113 of the Bankruptcy Code, which applies a “fair and equitable treatment” standard in connection with rejection of a collective bargaining agreement. Terminating fewer than all pension plans, according to the bankruptcy court, would violate that standard. The court also noted that the debtors could have achieved the same aggregate consideration of the plans by merging the three plans and seeking to terminate a single plan.

Second, the Court approved termination of the three plans even though the debtors could afford contributions required for two of the plans because no lender would provide financing to the debtors unless the pension plans were terminated. As described in the opinion, only one lender expressed any interest in providing financing to the debtors, and this lender would not provide financing unless the plans were terminated. Inability to obtain financing has been used before as a basis for meeting the reorganization distress test, but usually it has been used in addition to a demonstration that the debtors could not afford to make required plan contributions. Here, with the proposed financing, the debtors would have had sufficient cash flow to support two of the three plans.

Third, the court declined to assume that the debtors could obtain three consecutive funding waivers (which would have permitted the debtors to meet minimum funding requirements for the plans). Even though a PBGC witness testified that he would recommend a waiver to avoid termination of the pension plans, the court found that the testimony was not credible because a waiver almost certainly would be conditioned on providing security and the debtors had no free assets to use as collateral. The court also noted that, even if the Internal Revenue Service (“IRS”) granted a waiver for one year, it may not do so in succeeding years because the IRS grants waivers only one year at a time.

Finally, the court considered the ability of non-debtor, non-US members of the debtors’ controlled group to maintain the plans. Even though the reorganization distress test does not directly apply to non-debtors, the court reviewed the ability of the non-debtor entities to enable

the debtors to support the pension plans. The court reviewed both the ability of each of the non-debtor, non-US companies to support the plans alone, as well as the ability of the debtors to obtain cash or value from the non-debtor, non-US entities. Based on this analysis, the court concluded that these entities could not enable the debtors to support the pension plans.