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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re:	)	Chapter 11
	)	
	)	
	)	
ROBERT E. DERECKTOR, INC.	)	Case No. 12-22393 (RDD)
	)	
	)	
Debtor	)	
	)	

OBJECTION OF THE PENSION BENEFIT GUARANTY CORPORATION TO THE DEBTOR'S DISCLOSURE STATEMENT AND NOTICE FOR AN ORDER APPROVING DISCLOSURE STATEMENT

The Pension Benefit Guaranty Corporation ("PBGC")[1], on its own and on behalf of the Retirement Income Plan for Bargaining Unit Employees of Robert E. Derecktor of Rhode Island, Inc. ("Pension Plan"), hereby objects to the Disclosure Statement ("Disclosure Statement") (Docket No. 162) filed by the Debtor on June 8, 2014 and the Notice of Hearing to Consider

[1] Capitalized terms not defined herein are defined in the Disclosure Statement or the Plan of Reorganization.

Approval of the Proposed Disclosure Statement (the "Notice") (Docket No. 164) , filed by the Debtor on June 11, 2014.

BACKGROUND

A. PBGC and the Employee Retirement Income Security Act

PBGC is a wholly-owned United States government corporation, and an agency of the United States, that administers the defined benefit pension plan termination insurance program under Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1301-1461 (2012). The program guarantees a secure, predictable retirement for nearly 32 million American workers in approximately 23,000 private sector pension plans.[2] When a pension plan covered by Title IV terminates without sufficient assets to pay promised benefits, PBGC typically becomes the statutory trustee of the plan and pays covered plan participants and their beneficiaries their pension benefits up to the limits established by Title IV. *See* 29 U.S.C. §§ 1321, 1322, 1361. PBGC is self-financed and is funded from four sources: (i) premiums paid by plan sponsors and their controlled group members; (ii) recoveries from employers whose underfunded pension plans terminate and their controlled group members; (iii) remaining assets, if any, in terminated plans; and (iv) investment income.[3]

Pursuant to ERISA, a sponsor of a pension plan covered by Title IV and the sponsor's controlled group members must satisfy certain financial obligations to the plan.[4] ERISA imposes responsibility on a controlled group member regardless of whether its employees

[2] PBGC 2013 Annual Report at p. 4, http://www.pbgc.gov/documents/2013-annual-report.pdf.

[3] A group of trades or business under common control, referred to as a "controlled group," includes, for example, a parent and its 80% owned subsidiaries. Another example includes brother-sister groups of trades or business under common control. *See* 29 U.S.C. § 1301(14)(A), (B); 26 U.S.C. § 414(b), (c); 26 C.F.R. §§ 1.414(b)-1, 1.414(c)-1, 1.414(c)-2.

[4] A group of trades or business under common control, referred to as a "controlled group," includes, for example, a parent and its 80% owned subsidiaries. Another example includes brother-sister groups of trades or business under common control. See 29 U.S.C. § 1301(14)(A), (B); 26 U.S.C. § 414(b), (c); 26 C.F.R. §§ 1.414(b)-1, 1.414(c)-1, 1.414(c)-2.

participate in the pension plan. The responsibilities of the plan sponsor and controlled group members to an on-going pension plan include the following: (1) paying the statutorily required minimum funding contributions to the pension plan, 26 U.S.C. § 412(b)(1), (2); 29 U.S.C.A. § 1082(b)(1), (2); and (2) paying flat-rate and variable-rate insurance premiums to PBGC, 29 U.S.C. §§ 1306, 1307.

The liabilities of the plan sponsor and controlled group members with regard to the pension plan are joint and several. *See* 26 U.S.C. § 412(b)(2); 29 U.S.C.A. § 1082(b)(2). *See also* 29 U.S.C. §§ 1307(e)(2), 1362(a). Therefore, should the plan sponsor default on its obligations to a pension plan, the resulting liability for the plan rests with its controlled group members.

ERISA provides the exclusive means for a plan sponsor to terminate a pension plan — a standard termination or a distress termination. *See* 29 U.S.C. § 1341(a)(1); *see also Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999). A standard termination requires sufficient assets to pay all of the pension plan's promised benefits. *See* 29 U.S.C. § 1341(b)(1)(D). A distress termination requires a showing, among other things, that the plan sponsor and each controlled group member satisfy one of the three financial distress criteria: (i) liquidation in bankruptcy; (ii) inability to reorganize in bankruptcy unless the pension plan terminates; or (iii) inability to pay debts when due and continue in business unless the pension plan terminates. *See* 29 U.S.C. § 1341(c)(2)(B). Separate from a standard and distress termination, PBGC can initiate termination of a pension plan pursuant to section 4042 of ERISA ("PBGC-initiated termination"). 29 U.S.C. § 1342.

Upon a distress termination or a PBGC-initiated termination of a pension plan, the contributing sponsor and controlled group members are still subject to certain liabilities with

regard to the terminated pension plan. For example, they become jointly and severally liable to PBGC for unfunded benefit liabilities of the pension plan. 29 U.S.C. § 1362(a), (b). ERISA explicitly assigns the recovery of a terminated pension plan's unfunded benefit liabilities exclusively to PBGC. 29 U.S.C. § 1362(b).

Upon termination, the plan sponsor and controlled group members remain jointly and severally liable to PBGC for any unpaid premiums — not just the flat-rate and variable-rate premiums, but also a termination premium at the rate of $1,250 per plan participant per year for three years. *See* 29 U.S.C. § 1306(a)(7). If the plan termination occurs while the plan sponsor and any controlled group members are attempting to reorganize in Chapter 11, and they ultimately obtain confirmation of a Chapter 11 plan of reorganization, their obligation to PBGC for termination premiums does not exist until after the Chapter 11 plan is confirmed and the Debtor exits bankruptcy. *See* 29 U.S.C. § 1306(a)(7)(B). Thus, under those circumstances, termination premiums are not a dischargeable claim or debt within the meaning of 11 U.S.C. §§ 101(5), 1141.

Finally, because PBGC typically becomes the statutory trustee of the terminated pension plan, it has authority to collect all amounts owed to the pension plan, including any unpaid minimum funding contributions for which the plan sponsor and controlled group members are jointly and severally liable. *See* 29 U.S.C. §§ 1082(c), 1342(d), 1362(a), (c); 26 U.S.C. § 412(c).

B. Debtor and the Pension Plan

The Debtor is the sponsor of the Pension Plan, within the meaning of Title IV of ERISA. *See* 29 U.S.C. §1301(a)(13). It is believed that the Pension Plan is a defined benefit plan covered by Title IV of ERISA. *See* 29 U.S.C. § 1321. If the Pension Plan were to terminate, the Debtor and any other members of its controlled group would become jointly and severally liable

to PBGC for the Pension Plan's unfunded benefit liability, unpaid premiums, and any unpaid minimum funding contributions. *See* 29 U.S.C. §§ 1082(b), 1306(a)(7), 1362(a); 26 U.S.C. § 412(b).

C. Debtor's Bankruptcy Proceedings

On February 27, 2012 ("Petition Date"), the Debtor filed a voluntary petition under Chapter 11 of Title 11, United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court").

PBGC timely filed proofs of claims relating to the Pension Plan for unfunded benefit liabilities, minimum funding contributions, and premiums. The Debtor informed PBGC that it has paid to the Pension Plan the minimum funding contributions owed for plan years 2013 and 2014. PBGC has requested documentation confirming those payments. PBGC estimates that the amount of the Pension Plan's unfunded benefit liabilities is $697,128; this claim is contingent on the termination of the Pension Plan. Also, if the Pension Plan terminates in either a distress or PBGC-initiated termination during the bankruptcy's reorganization process, the Debtor would be responsible for approximately $502,500 in termination premiums upon its emergence from bankruptcy, payable in equal installments over three years.

On June 8, 2014, the Debtor filed the Disclosure Statement and attached as an exhibit, the Plan of Reorganization ("POR"). On June 11, 2014, the Debtor filed the Notice of hearing to consider approval of the Disclosure Statement.

Argument

PBGC, on its own behalf and on behalf of the Pension Plan, objects to the Disclosure Statement because it fails to provide "adequate information," as that term is defined under 11 U.S.C. § 1125. As used in that section, adequate information means:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor . . . that would enable a hypothetical reasonable investor . . . to make an informed judgment about the plan…..

11 U.S.C. § 1125(a)(1). *See In re Momentum Mfg. Corp.*, 25 F.3d 1132, 1136 (2d Cir. 1994); *Sure-Snap Corp. v. State Street Bank & Trust Co.*, 948 F.2d 869, 873 (2d Cir. 1991); *also Hall v. Vance*, 887 F.2d 1041, 1043 (10th Cir. 1989). Furthermore, Section 1125(b) of the Bankruptcy Code requires that in order to solicit votes on a plan of reorganization, concurrent with the solicitation, "a written disclosure statement approved . . . by the court as containing adequate information." must have been transmitted to the holders of claims and interests. 11 U.S.C. § 1125(b). An adequate disclosure statement should "clearly and succinctly inform the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution." *In re Ferretti*, 128 B.R. 16, 19 (Bankr. D.N.H. 1991). The Disclosure Statement submitted by the Debtor fails to meet this threshold for the reasons discussed below.

I. The Disclosure Statement Is Silent As to Whether the Pension Plan Will Continue Or Will Terminate

The Disclosure Statement is completely silent as to the Pension Plan. This is despite the fact that the Debtor attempted and failed to accomplish a standard termination of the Pension Plan, even after PBGC granted an extension of time. Although the Debtor has made representations to PBGC that it will attempt again to complete a standard termination of the Pension Plan at some point in the future, this representation is not present anywhere in the Disclosure Statement or the POR.

The Debtor should disclose whether it intends to continue the Pension Plan post-reorganization or to seek to terminate the Pension Plan in either a standard or distress

termination. If the Debtor decides to continue the Pension Plan, it must disclose its financial wherewithal to afford the Plan. If the Debtor decides to pursue a standard termination, it must disclose how it will satisfy the benefit liabilities under the Pension Plan. If the Debtor decides to pursue a distress termination, it must disclose how the statutory distress criteria for such a termination are met.

II. The Disclosure Statement Fails to Disclose the Debtor's Obligations and Liabilities Relating to the Pension Plan

The Disclosure Statement should disclose the Debtor's statutory liabilities relating to the Pension Plan under ERISA and the Internal Revenue Code.

PBGC suggests adding the following proposed language to the Disclosure Statement in order to satisfy its objection:

> The Debtor is the sponsor of the Retirement Income Plan for Bargaining Unit Employees of Robert E. Derecktor of Rhode Island, Inc. ("Pension Plan"). It is believed that the Pension Plan is a defined benefit pension plan covered by Title IV of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") 29 U.S.C. §§ 1301-1461 (2012).
>
> The Debtor and members of the Debtor's controlled group (within the meaning of 29 U.S.C. § 1301(a)(14)), are jointly and severally liable for insurance premiums owed to PBGC. *See* 29 U.S.C. §§ 1306, 1307. The Debtor and all members of the Debtor's controlled group are also jointly and severally liable for contributions owed to the Pension Plan in satisfaction of ERISA's and the Internal Revenue Code's minimum funding standards ("Minimum Funding Contributions"). *See* 29 U.S.C. §§ 1082, 1083; 26 U.S.C. §§ 412, 430.
>
> PBGC is the federal agency that administers the nation's defined benefit pension plan termination insurance program under Title IV of ERISA. When an underfunded pension plan terminates with insufficient assets to pay benefits, PBGC generally becomes statutory trustee of the pension plan and pays benefits to the plan's participants up to statutory limits.
>
> Notwithstanding any other provision in the Disclosure Statement, Plan of Reorganization, Confirmation Order, Bankruptcy Code, or any document filed in the Debtor's bankruptcy proceedings, the Debtor must satisfy ERISA's *exclusive* means to terminate the Pension Plan. *See* 29 U.S.C. § 1341(a)(1).

[If the Debtor intends to continue the Pension Plan, include the following:
"The Pension Plan will continue through the Debtor's reorganization. The Debtor estimates that the projected minimum funding contributions owed to the Pension Plan for the following five years are: _____ . The Debtor and/or Reorganized Debtor has the financial wherewithal to continue to afford the Pension Plan, as evidenced by _____.]

[If Debtor is going to terminate the Pension Plan in a standard termination, including the following:
"The Debtor will terminate the Pension Plan in a standard termination in accordance with 29 U.S.C. § 1341(b) and corresponding regulations. *See* 29 C.F.R. §§ 4041.21-4043.31. A standard termination requires sufficient assets to pay all of the Pension Plan's promised benefits. See 29 U.S.C. § 1341(b)(2)(A)(i)(III). Accordingly, the Debtor has $_____, which is the amount needed to complete the standard termination, as evidenced by _____."]

[If the Debtor is going to terminate the Pension Plan in a distress termination:
"The Debtor will seek to terminate the Pension Plan in a distress termination. *See* 29 U.S.C. § 1341(c). The Debtor and each member of its controlled group satisfy the following distress termination criteria: [choose appropriately (i) liquidation in bankruptcy; (ii) inability to reorganize in bankruptcy unless the pension plan terminates; or (iii) inability to pay debts when due and continue in business unless the pension plan terminates]. *See* 29 U.S.C. § 1341(c)(2)(B). If the Debtor and/or its controlled group members fail to meet the statutory requirements for a distress termination, the Pension Plan will remain ongoing, and the Debtors and each controlled group member remain liable for amounts owed in continuing the Pension Plan."]

The Pension Plan may be terminated by a PBGC-initiated termination. *See* 29 U.S.C. § 1342(a). Any termination of the Pension Plan shall be in conformity with statutory and regulatory requirements as well as the rules and requirements of the PBGC and the U.S. Internal Revenue Service. Upon a distress termination or a PBGC-initiated termination, the Debtor becomes jointly and severally liable to PBGC for the Pension Plan's unfunded benefit liabilities. 29 U.S.C. § 1362(a), (b).

Upon a distress termination or a PBGC-initiated termination, the Debtors remain jointly and severally liable for any unpaid minimum funding contributions and any unpaid, flat-rate and variable-rate premiums. PBGC, as statutory trustee of the Plan, would have authority to pursue and collect any unpaid minimum funding contributions owed to the Plan. In addition, upon a distress or PBGC-initiated termination, the Debtors are jointly and severally liable for a termination premium at the rate of $1,250 per plan participant per year for three years. *See* 29 U.S.C. §1306(a)(7).

PBGC has filed timely proofs of claims against the Debtor for (1) the

Pension Plan's unfunded benefit liabilities, (2) unpaid minimum funding contributions, and (3) unpaid premiums. PBGC currently estimates the Pension Plan's unfunded benefit liabilities to be $697,128; this claim is contingent on the Pension Plan terminating, other than through a standard termination. PBGC also estimates the termination premium to be $502,500. If the Pension Plan terminates in a standard termination, PBGC's claims are estimated to be zero.

III. The Disclosure Statement Fails to Disclose How the Pension Plan Obligations and Liabilities Will Affect the Debtor's Cash Flow

The Debtor proposes to pay any claims, by using its cash on hand on the Confirmation Date.[5] But, the Disclosure Statement fails to adequately disclose what effect the payment of the Pension Plan obligations – whether the Plan terminates or remains ongoing -- will have on the Debtor's cash flow. The Debtor asserts that on the Effective Date of the POR, the Debtor will need $201,000.[6] The Debtor discloses that it expects to have total net cash of only $240,000 so that there will only be available $39,000 to fund working capital and any other expenses.[7] There is no discussion of the Pension Plan costs among the items needing funding. The Debtor should adequately disclose the impact of funding the Pension Plan – whether it be to fund the plan as an ongoing concern or to fund the plan's termination -- will have on its cash flow.

IV. The Disclosure Statement Fails to Disclose Adequate Information Justifying the Overly Broad Release Provisions in the POR

The Disclosure Statement fails to provide adequate information justifying the need for overly broad release, exculpation, and injunction provisions that release non-debtors from liability.[8] The POR has similar language to the foregoing.[9] The Debtor should disclose why

[5] *See* Disclosure Statement, Section II, p. 9.
[6] *See* Disclosure Statement, Section III.B, p. 20.
[7] *See* Disclosure Statement, Section I. G, p. 8.
[8] *See* Disclosure Statement, Section II, H – I.
[9] *See* Plan of Reorganization, Art. VIII.

these releases, injunctions and exculpations are necessary and why they do not violate the Bankruptcy Code.

PBGC would withdraw this aspect of its objection if the following provision were included in the Disclosure Statement:

> Nothing in the Debtor's bankruptcy proceedings, Confirmation Order, Plan of Reorganization, the Bankruptcy Code (and section 1141 thereof), or any other document filed in the Debtor's bankruptcy case shall in any way be construed to discharge, release, limit, or relieve the Debtor or any other party, in any capacity, from any liability or responsibility with respect to the Retirement Income Plan for Bargaining Unit Employees of Robert E. Derecktor of Rhode Island, Inc. ("Pension Plan") or any other defined benefit pension plan under any law, governmental policy, or regulatory provision. PBGC and the Pension Plan shall not be enjoined or precluded from enforcing such liability or responsibility by any of the provisions of the Plan of Reorganization, Confirmation Order, Bankruptcy Code, or any other document filed in the Debtor's bankruptcy case.

V. Retention of Allowed Interests Violates the Absolute Priority Rule

The Disclosure Statement and the POR provide that Class 3, which consists of "Allowed Interests of Derecktor Holdings, Inc., the holder of 100% of the equity Interest in the Debtor," is unimpaired, subject to the acceptance of the POR by the general unsecured creditors in Class 2.[10]

Section 1129(b)(2)(B)(ii) of the Bankruptcy Code provides that, with respect to a class of unsecured claims, the holder of any interest that is junior to the claims of such class will not retain any property under the plan on account of such junior interest ("Absolute Priority Rule"). 11 U.S.C. § 1129(b)(2)(B)(ii); *see also Bank of Am. Nat. Trust and Sav. Ass'n v. 203 North LaSalle*, 526 U.S. 434, 454-58 (1999).

In the present case, Class 2, which consists of "Allowed Unsecured Claims," is impaired, while Class 3, which consists of holders of Allowed Interests in the Debtor, is unimpaired. The

[10] *See* Disclosure Statement, II. B, p. 11; *See* POR, Article II.

Disclosure Statement fails to adequately disclose whether any new value is being provided and the POR is silent on this aspect as well. The Supreme Court has held that this type of provision with respect to equity holders to be a violation of the Absolute Priority Rule.

In *Bank of America National Trust and Savings Association*, the Supreme Court held that, even assuming that the Absolute Priority Rule in § 1129(b)(2)(B)(ii) were to have a new value exception, the debtor's pre-bankruptcy equity holders could not contribute new capital and receive ownership interest in the reorganized entity without allowing others to compete for that equity. 526 U.S. at 434, 458; *and cf. Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 527 (1941) ("…. any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights' of creditors 'comes within judicial denunciation.") (*citing Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co.*, 174 U.S. 674, 684 (1899)); *In re DBSD N. America, Inc.*, 634 F.3d 79, (2d. Cir. 2011) (plan can only be confirmed if shareholder "does "not receive or retain" "any property"", since creditors not receiving full value). Thus, the Debtor fails to adequately disclose how the proposed POR does not violate the Absolute Priority Rule.

CONCLUSION

For the forgoing reasons, PBGC objects to the Debtor's Disclosure Statement and requests that it be modified as stated above. If the Debtor cannot adequately disclose the issues identified above, particularly in light of the Pension Plan funding issues and the violations of the Absolute Priority Rule that have been identified, it calls into question the viability of the POR. If the POR is not confirmable, the Court should not approve the Disclosure Statement. *See In re Filex, Inc.*, 116 B.R. 37, 41 (Bankr. S.D.N.Y. 1990) (approval of disclosure statement denied because plan nonconfirmable); also *In re Silberkraus*, 253 B.R. 890, 899 (Bankr. C.D. Cal. 2000)

(if "a plan is on its face nonconfirmable, as a matter of law, it is appropriate for the court to deny approval of the disclosure statement describing the nonconfirmable plan").

Dated: July 17, 2014
Washington, DC

Respectfully Submitted,

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