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BANKRUPTCY PRACTICE

'Visteon': Third Circuit Alters Landscape Of Retiree Benefits in Bankruptcy

On July 13, 2010, the U.S. Court of Appeals for the Third Circuit in the Chapter 11 case of auto supplier Visteon Corporation reversed the courts below, which had permitted Visteon to terminate the health and insurance benefits of 2,100 retirees without complying with the procedures set forth in §1114 of the Bankruptcy Code. The Third Circuit held that even if an employer could unilaterally terminate outside of bankruptcy retiree benefits consistent with plan documents, collective bargaining obligations and the prescriptions of the Employee Retirement Income Security Act of 1974, Bankruptcy Code §1114 explicitly limited a debtor's ability to terminate during bankruptcy those retiree benefits.[1] Not only is *Visteon* one of the most significant appellate decisions to date on the topic of retiree benefits in bankruptcy, it is also notable because it endorses a reading of the Bankruptcy Code that expands a party's prepetition rights, which is counter to the usual contraction of prepetition rights in bankruptcy.

By **John J. Rapisardi**

Retiree Benefits in Chapter 11

Bankruptcy Code §1114 is designed to protect the health, life, and disability benefits of retirees, who would otherwise be without such benefits, by providing procedures and heightened standards for modifying the payment of retiree benefits in a Chapter 11 case.[2] Section 1114 was enacted in the wake of the mid-1980s' bankruptcy of steelmaker LTV Steel Corporation.

Under §1114, a debtor is required to pay retiree benefits and is prohibited from unilaterally terminating or modifying retiree benefits unless such termination or modification is agreed to by the retirees' authorized representative or authorized by court order.[3] Prior to moving for modification of a benefit plan, the debtor must provide the retirees' authorized representative with a proposal and information about the company's financial situation.

After making its proposal, the debtor must meet and confer with the retirees' representative to attempt to reach "mutually satisfactory modifications of such retiree benefits."[4] If the foregoing requirements have been met, and the authorized representative rejects the proposed modifications without good cause, the debtor may request the bankruptcy court to order such modification if it is necessary for the debtor's reorganization and it can show that creditors and affected parties are treated fairly and equitably and a balancing of the equities clearly favors such modification.[5]

> Bankruptcy Code §1114 provides procedures and heightened standards for modifying the payment of retiree benefits in a Chapter 11 case.

The bankruptcy court may not authorize any plan modification that is less beneficial to retirees than the terms of the debtor's proposal.[6] The retirees, however, may later apply for an improvement in benefits, and neither the debtor nor the retirees' representative is precluded from making more than one motion for modification.[7]

Background

Visteon, formerly a division of the Ford Motor Corporation, is one of the world's largest suppliers of automotive parts. Workers at two of Visteon's Indiana plants received health and life insurance benefits upon retirement pursuant to collective bargaining agreements and summary benefit plan descriptions. Under these documents, Visteon reserved the right to suspend, modify, amend, or terminate benefits at will.

On May 28, 2009, Visteon filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Delaware. During the case, Visteon filed a motion seeking authorization to terminate all retiree benefit plans pursuant to Bankruptcy Code §363(b)(1), which permits bankruptcy courts to approve non-ordinary course transactions on a business judgment rule-based standard. The retirees, represented by the Industrial Division of the Communications Workers of America, opposed the motion, arguing that Visteon could not terminate any retiree benefits during a Chapter 11 case without first complying with the requirements of §1114.

The bankruptcy court granted Visteon's motion, concluding that, because Visteon had the right under non-bankruptcy law to terminate benefits unilaterally, §1114 did not apply and Visteon's decision to terminate retiree benefits was a reasonable exercise of business judgment under §363(b).[8] The union appealed the decision to the district court, which affirmed the bankruptcy court's holding, while noting that the union's argument had some merit because neither the U.S. Supreme Court nor any circuit court had ruled on the issue.[9] The union appealed to the Third Circuit.

The Decision

On appeal, the union argued that the plain language of §1114 applied to any and all retiree benefits, whether or not the debtor could terminate those benefits outside of bankruptcy pursuant to the applicable plan documents.

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Visteon argued the Third Circuit should follow the majority of lower courts that a debtor need not comply with the procedures and requirements of §1114 if it had a right to unilaterally terminate retiree benefits under the retirement plan. Visteon contended that restricting a debtor from terminating during bankruptcy those retiree benefits that it could terminate at will outside of bankruptcy, led to the absurd result of expanding prepetition rights and did not reflect congressional intent.

The Third Circuit held that §1114 plainly and broadly applies to any and all retiree benefits clearly limiting the debtor's ability to terminate retiree health and life insurance benefits even if such benefits could be otherwise terminated under the applicable plan and Employee Retirement Income Security Act of 1974.

Analysis

Although the Third Circuit is the highest court to have ruled that §1114 is applicable even when the debtor has a clear right under the applicable benefit plan to unilaterally terminate those benefits outside of bankruptcy, it is not the first court to reach this result. In *In re Farmland Industries Inc.*,[10] the debtors sought court approval to terminate retirees' life insurance benefits. Under the policy, the debtors retained the right to unilaterally terminate or amend the life insurance program. In *Farmland*, the debtors argued that the court should apply the business judgment standard used for the acceptance or rejection of executory contracts under Bankruptcy Code §365. Both the bankruptcy court in *Farmland* and the Third Circuit in *Visteon* found that, on its face, the language of the statute is clear.

Section 1114(e)(1) plainly states that, "[n]otwithstanding any other provision of this title, the debtor in possession, or the trustee…shall timely pay and shall not modify any retiree benefits…" unless a modification is agreed to by the parties or ordered by the court pursuant to the specific procedures set out in §1114. The Third Circuit seized on the literal breadth of §1114 and was not persuaded to limit its scope despite the expansion on retirees' prepetition rights that such a reading provides.

While the Third Circuit acknowledged that such an expansion of a party's prepetition rights was uncommon in bankruptcy, it was persuaded by numerous statements in the legislative history evincing Congress' desire to afford otherwise helpless retirees with heightened protections in bankruptcy, when their rights to benefits are most vulnerable. The court did point to the language of §1114 that operated to limit this expansive reading—namely, §1114's application only to health, accident, disability, and death benefits and the exclusion of high-income retirees from the scope of the provision's protection.

Prior to the Third Circuit's decision in *Visteon*, the majority of lower courts, including the U.S. Bankruptcy Court in the Southern District of New York in *In re Delphi Corp.*,[11] have held that a debtor does not have to comply with the more onerous procedures and requirements of §1114 if it has a right to unilaterally terminate retiree benefits under the retirement plan and can proceed to terminate those benefits under §363.[12] These courts reasoned that §1114 does not expressly limit the debtor in possession's ability to exercise a reserved right under a prepetition contract to terminate retiree benefits and that §1114 does not preclude termination. Much of Visteon's argument relied on this prevailing majority view. However, the Third Circuit hypothesized that these other courts may have erroneously relied on their own views about sensible policy, rather than on the congressional policy choice reflected in the unambiguous language of §1114.

Another astute dimension to the Third Circuit's opinion was its synthesis of its ruling with the notion that it could lead to a moral hazard, whereby distressed companies could jettison their benefit plans at will on the eve of bankruptcy instead of facing the procedures of §1114 postpetition. However, Bankruptcy Code §1114 was modified in 2005 to include a provision codified in subsection (l) that mandates debtors to retroactively reinstate retiree benefits that were modified within 180 days prepetition. The Third Circuit viewed this added protection as supportive of a congressional intent to supply heightened protections to retirees during bankruptcy and limit companies' ability to opportunistically shed benefits while in distress.

Conclusion

Although *Visteon* involves a rare situation in which a Bankruptcy Code provision has been interpreted to expand prepetition rights rather than contract or limit those rights, the Third Circuit was persuaded that §1114 reflects a special concern for retirees who, in many cases are a significant creditor constituency, but often lack the resources to make their voices heard in a bankruptcy case or, more critically, obtain benefits to substitute for those they relied upon for their health and well-being before bankruptcy.

The impact of the *Visteon* decision has already been felt by debtors in the Third Circuit. In June, Nortel Networks Corporation withdrew its motion to cut off medical benefits and disability pay to 4,000 retirees.[13] Although the *Visteon* decision is not controlling on courts outside of the Third Circuit, given Delaware's popularity as a venue for large Chapter 11 cases and the high regard held for the Third Circuit's opinions on bankruptcy issues, other courts' response to the Third Circuit's interpretation of §1114 will be an interesting development that bankruptcy practitioners should monitor, especially, in the Second Circuit, which many years ago took a narrower approach to §1114 under different circumstances in *LTV Steel Co. v. United Mine Workers* (*In re Chateaugay Corp.*).[14]

Aside from how courts react to *Visteon*, debtors' counsel will undoubtedly elevate the priority of the treatment of retiree benefits during pre-bankruptcy planning, given the limitations on postpetition termination, although in many cases it will likely be difficult and impracticable to modify or terminate benefits at will six months before filing for Chapter 11.

1. *In re Visteon Corp.*, No. 10-1944, 2010 WL 2735715 (3d Cir. July 13, 2010).

2. See 11 USC §1114

3. Id. §1114(e)(1).

4. Id. §1114(f)(2).

5. Id. §1114(g).

6. Id.

7. Id.

8. *In re Visteon Corp.*, No. 10-1944, 2010 WL 1416796 (Bankr. D. Del. April 8, 2010).

9. Id.

10. *In re Farmland Indus., Inc.*, 294 B.R. 903 (W.D. Mo. 2003).

11. *In re Delphi Corp.*, No. 05-44481, 2009 WL 637315 (Bankr. SDNY March 10, 2009).

12. See, e.g., *LTV Steel Co. v. United Mine Workers* (*In re Chateaugay Corp.*), 945 F.2d 1205, 1208-09 (2d Cir. 1991); *Delphi*, 2009 WL 637315 at *6; *In re N. Am. Royalties, Inc.*, 276 B.R. 860 (Bankr. E.D. Tenn. 2002); *In re Doskocil Cos. Inc.*, 130 B.R. 870 (Bankr. D. Kan. 1991).

13. *In re Nortel Networks, Inc.*, Case No. 09-10138 (KG) (Bankr. D. Del. June, 21, 2010) (docket no. 3204).

14. 945 F.2d 1205 (2d Cir. 1991).