

Visteon's Impact On Debtors' Ability To Cancel Benefits

Law360, New York (August 20, 2010) -- As companies struggle to survive in a distressed economy, one of the main drags on earnings and profitability are the enormous unfunded legacy costs to employees and retirees. Escalating legacy costs attributable to employee pension plans and retiree benefits — primarily agreements to provide health insurance — have been identified as a precipitating factor in numerous high-profile Chapter 11 cases as companies seek to reap the benefits of the Bankruptcy Code to reduce or eliminate those liabilities from their balance sheets.

In response to earlier bankruptcy court decisions that allowed companies in Chapter 11 to shed those legacy liabilities with little or no notice to retirees, Congress enacted Section 1114 of the Bankruptcy Code, which requires Chapter 11 debtors to follow certain procedures and to satisfy heightened standards before terminating retiree benefits.

The U.S. Court of Appeals for the Third Circuit recently issued a decision in the bankruptcy proceedings of Visteon Corp., *IUE-CWA v. Visteon Corp.*, No. 10-1944 (3d Cir. July 13, 2010), adopting a very restrictive view of Section 1114 of the Bankruptcy Code. The Third Circuit held that a Chapter 11 debtor must comply with the notice and other requirements of Section 1114, even if the debtor had a contractual right to terminate a retiree benefit plan at will and without notice outside of bankruptcy. This decision is consistent with existing Third Circuit authority applying a heightened standard for modifying collective bargaining agreements under Section 1113 of the Bankruptcy Code.

Section 1114 of the Bankruptcy Code prevents a Chapter 11 debtor from unilaterally modifying or terminating certain retiree benefits without approval of the bankruptcy court or agreement from the authorized representative of retired employees. Prior to seeking court approval to modify retiree benefits, the debtor must make a proposal to the authorized representative based upon “the most complete and reliable information available at the time of the proposal.”

Additionally, the modifications must be “necessary to permit reorganization” and provide for “fair and equitab[le]” treatment of the debtor, creditor and all affected parties. Section 1114 also requires that the retirees’ representative be provided with the “relevant information necessary to evaluate the proposal.” Lastly, the debtor must confer with the retiree’s representative in a good faith effort to reach a mutually satisfactory modification of the retirees’ benefits.

Through this section, Congress attempted to minimize the impact of Chapter 11 filings on retirees who rely on retiree benefits for support, while also recognizing that modifications to retiree benefits may be necessary for companies to continue as an ongoing enterprise. The application of Section 1114, however, has been at the heart of the debate in several Chapter 11 cases.

One of the most contentious issues has been whether Section 1114 applies to all retiree benefit plans, including those a debtor could have terminated at will before entering bankruptcy. On its face, the statute mandates that the procedural requirements of Section 1114(f) be satisfied before a debtor may either modify or terminate retiree benefits without the retirees' consent.

Despite the plain language of the statute, the majority of bankruptcy courts and district courts that have addressed the issue have concluded that Section 1114 does not limit a debtor's ability to terminate benefits during bankruptcy when it has reserved the right to do so in the applicable plan documents. Those courts reasoned that Section 1114 does not provide retirees with greater rights than those contained in the plan documents and applicable nonbankruptcy law.

A minority of courts, however, has disagreed, finding that benefits must continue during bankruptcy regardless of whether the debtor could have been terminated outside of bankruptcy. Those minority courts relied on the clear language of the statute that provides that the debtor shall not modify "any retiree benefits."

The Visteon decision parted with the conclusion reached by most courts that have addressed the issue and held that Section 1114 of the Bankruptcy Code applies to all retiree benefits, even those that the plan sponsor could have unilaterally terminated outside of bankruptcy. The Third Circuit reasoned that Section 1114 "could hardly be clearer" in providing that a debtor's ability to terminate or modify retiree benefits applies to any payments to any entity or person under any plan, fund or program in existence when the debtor files for bankruptcy. The Third Circuit's decision has actually made it more difficult for a Chapter 11 debtor to shed its legacy liabilities in bankruptcy than would be the case outside of a bankruptcy proceeding.

Although the decision in Visteon is based upon the "plain meaning" of the statute, the court went to great length to delve into the legislative history surrounding the enactment of Section 1114 and relied on the intent of Congress to protect retiree benefits during bankruptcy, even if it provides retirees more rights than they would otherwise have outside of bankruptcy. The court noted that Section 1114 was enacted in response to LTV Corp.'s termination of health and life insurance benefits of 78,000 retirees during its 1986 Chapter 11 bankruptcy, with no advance notice. The decision quotes the legislative history and noted that Congress found that retirees are particularly vulnerable to termination of benefits because they often have extensive medical problems and lack the income to purchase insurance in the marketplace.

The Visteon decision is not the first time the Third Circuit has made a ruling that restricts a Chapter 11 debtor's ability to reduce ongoing labor costs. Visteon is consistent with the Third Circuit's decision in *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074 (3d Cir. 1984) interpreting Section 1113 of the Bankruptcy Code and making rejection of collective bargaining agreements in bankruptcy nearly impossible.

To reject a collective bargaining agreement, the Third Circuit held in *Wheeling-Pittsburgh* that a debtor must show that rejection is essential to avoid a short-term liquidation; it is not sufficient to demonstrate that the rejection would aid in the "general long-term viability" of the debtor or its "long-term economic health." Clearly, this is a hard standard to meet and is at variance with other appellate courts. In other courts, such as the Second Circuit, a debtor need only show that the proposed modifications, as a whole, have a significant impact on operations and are required to permit the debtor to successfully compete in the marketplace.

The Third Circuit's decision in Visteon, in view of its previous rulings on Section 1113 of the Bankruptcy Code, gives retiree plan recipients increased leverage in their former employer's bankruptcy cases. While not addressed in Visteon, it is likely that the Third Circuit would adopt the same strict standard for modifications of retiree benefits under Section 1114 as it did in *Wheeling-Pittsburgh* for rejection of collective bargaining agreements, given that the standard enunciated in Section 1114 is almost identical to the standard set forth in Section 1113.

Companies that resort to bankruptcy protection with an eye toward eliminating ever-growing unfunded pension and other benefit liabilities to their employees must now consider the best venue to achieve those objectives. While courts within the Third Circuit may still find that a debtor's termination of benefits or rejection of a collective bargaining agreement is warranted, the strict requirements imposed on sections 1114 and 1113 of the Bankruptcy Code certainly gives retirees a greater chance to avoid termination of their benefits in the cases venued in the Third Circuit.

The retirees' victory in Visteon may be short-lived. The court recognized that once a debtor emerges from Chapter 11, its ability to unilaterally terminate benefits again becomes a matter of contractual rights and Section 1114 no longer applies. Visteon has made clear that it intends to terminate these benefits once its Chapter 11 case is resolved. Indeed, since the Visteon decision, the debtor and its retirees are still wrestling with the scope of this decision and whether it is applicable to all employees or only those who appealed the lower court ruling.

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