

July 19, 2010

MEMORANDUM TO CLIENTS

RE: Third Circuit Extends Section 1114 Protection to Non-Vested Retiree Benefits

On July 13, 2010, the United States Court of Appeals for the Third Circuit held that section 1114 of title 11 of the United States Code ("Bankruptcy Code") applies to all retiree benefits, even those that the plan sponsor could have terminated outside of bankruptcy. In In re Visteon Corp., et al., --- F.3d ----, 2010 WL 2735715 (3rd Cir. July 13, 2010), the Third Circuit broke with the conclusion reached by most courts that have addressed the issue and found that section 1114 "could hardly be clearer. It restricts a debtor's ability to modify any payments to any entity or person under any plan fund or program in existence when the debtor files for Chapter 11 bankruptcy. . . ." Id. at *8 (emphasis in original). Accordingly, the court found that section 1114 limits a debtor's ability to terminate during bankruptcy those retiree benefits that it could, consistent with plan documents, collective bargaining agreements and ERISA, terminate unilaterally outside of bankruptcy. This decision, plus the existing Third Circuit authority applying a heightened standard for modifying retiree benefits under section 1114, makes the Third Circuit a less attractive venue for debtors seeking to modify retiree benefits. See Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., 791 F.2d 1074, 1080-81 (3d Cir. 1986) (under similar section 1113, permitting modification only to the extent required to avoid liquidation of the debtor).

Section 1114 provides that a debtor, notwithstanding any other provision of the Bankruptcy Code, "shall timely pay and shall not modify" retiree benefits except as permitted under the procedures set forth in section 1114. 11 U.S.C. § 1114(e). The procedures under section 1114 require negotiation with retiree representatives concerning modification. 11 U.S.C. § 1114(f), (g), (k). If no agreement is reached, the court may order modification of retiree benefits upon a showing that modification of retiree benefits (1) is necessary to permit the reorganization of the debtor, (2) assures that all creditors, the debtor and all affected parties are treated fairly and equitably, and (3) is clearly favored by the balance of the equities. 11 U.S.C. § 1114(g). "Retiree benefits" is broadly defined to mean "payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents" for medical, life, accident disability, or death benefits under "any plan fund or program . . . maintained or established in whole or in part by the debtor prior to filing a petition" under Chapter 11 of the Bankruptcy Code. 11 U.S.C. § 1114(a).

Most courts that have addressed the issue have interpreted section 1114 to mean that retiree benefits must be timely paid and not modified only if the benefits are vested, i.e., if the debtor would be obligated to continue to pay them outside of bankruptcy. E.g., In re Doskocil, 130 B.R. 870 (D. Kan. 1991). A minority of courts has disagreed, finding that benefits must continue during bankruptcy regardless of whether they could have been terminated outside of bankruptcy. E.g., In re Farmland Indus. Inc., 294 B.R. 903 (Bankr. W.D. Mo. 2003).

Visteon, one of the world's largest automobile suppliers, provided certain health and life insurance benefits to retirees of its plants. In the plan documents and summary plan descriptions for these welfare plans, Visteon suggested that it planned to continue providing these benefits indefinitely. However, Visteon did not guarantee that they would provide such coverage for life, and more importantly, reserved its right to modify or terminate coverage at any time and manner to the extent permitted by law.

On May 28, 2009, Visteon filed a petition for Chapter 11 bankruptcy. Subsequently, the company moved for permission to terminate all United States retiree benefit plans under section 363(b)(1) of the Bankruptcy Code. Several groups of retirees objected, arguing that Visteon could not terminate any retiree benefits during a Chapter 11 proceeding without first complying with the requirements of section 1114. The bankruptcy court concluded that, because Visteon had the right under non-bankruptcy law to terminate benefits unilaterally, section 1114 did not apply.

The union appealed, arguing that the plain language and legislative history of section 1114 indicates that Congress intended to restrict a debtor's ability to modify or terminate, except through the section 1114 process, any retiree benefits during a Chapter 11 bankruptcy proceeding, regardless of whether the debtor could terminate those benefits outside of bankruptcy. Visteon and the Official Committee of Unsecured Creditors countered that it would be absurd and contrary to congressional intent to require continuation of retiree benefits during bankruptcy that would be terminable at will outside of bankruptcy.

The Third Circuit agreed with the unions, holding that section 1114 "is unambiguous and clearly applies to any and all retiree benefits, including the ones at issue here." In re Visteon, 2010 WL 2735715 at *6. As explained by the Third Circuit, "the plain language of § 1114 produces a result which is neither at odds with legislative intent, nor absurd. Id. Accordingly, disregarding the text of that statute is tantamount to a judicial repeal of the very protections Congress intended to afford in these circumstances. We must, therefore, give effect to the statute as written." Id.

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Authors: Lonie A. Hassel and Will Wilder

If you have any questions, please contact your regular Groom contact or any of the attorneys listed below:

Gary M. Ford	gford@groom.com	202-861-6627
Thomas S. Gigot	tgigot@groom.com	202-861-6624
Lars C. Golumbic	lgolumbic@groom.com	202-861-6615
Lonie A. Hassel	lhassel@groom.com	202-861-6634
Michael J. Prame	mprame@groom.com	202-861-6633
Will E. Wilder	wwilder@groom.com	202-861-6640