Section 1114 Basics

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I. Section 1114 of title 11 of the United States Code ("Bankruptcy Code") requires a debtor to continue to pay "retiree benefits" under certain circumstances after a bankruptcy filing.

A. "Retiree benefits" are payments to provide or reimburse retired employees, their spouses and dependents for medical, surgical or hospital care, and sickness, accident, disability or death benefits under any plan, fund or program (insured or self-insured) maintained or established in whole or in part by the debtor prior to filing a Chapter 11 petition. 11 U.S.C. § 1114(a)

B. Under section 1114, "notwithstanding any other provision of this title," the debtor "shall timely pay and shall not modify any retiree benefits" except upon court order or agreement with the retirees' authorized representative. 11 U.S.C. § 1114(e).

C. Most courts 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). One court recently concluded, however, that benefits must continue during bankruptcy regardless of whether they could have been terminated outside of bankruptcy. *In re Farmland Indus. Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003).

II. Determining Whether Retiree Benefits are Vested

A. Unlike pension benefits, ERISA does not require so-called "welfare" benefits to be vested, but they may be vested by contract.

B. Retiree benefits may become vested through language in collective bargaining agreements, plan documents, summary plan descriptions, and other related documents.

C. No special words are required. Courts look for language that signifies the employer's intent to provide benefits throughout a participant's retirement, for example --

1. Statement that benefits in retirement "will be continued for the rest of your life," *Helwig v. Kelsey-Hayes Co.,* 93 F.3d 243, 248 (6th Cir. 1996).

2. Provisions saying that the company "will provide insurance benefits [to retirees] equal to the active group," *International Union, UAW v. Yard-Man, Inc.*, 716 F.2d 1476, 1480 (6th Cir. 1983).

3. Retired employees "after completion of twenty years of full-time permanent service and at least age 55 will be insured." *Devlin v. Empire Blue Cross & Blue Shield*, 274 F.3d 76, 79 (2d Cir. 2001), *cert. denied,* 123 S. Ct. 1015 (2003).

D. "Yard-Man" inference.

1. In *U.A.W. v. Yard-Man, Inc.*, 716 F.2d 1476, 1482-83 (6th Cir. 1983), the Sixth Circuit found that the general durational limits in a CBA that provides for retiree health benefits did not necessarily limit the plan sponsor's obligation to continue to provide retiree health obligations after the CBA expired. *Accord Maurer v. Joy Technologies, Inc.*, 212 F.3d 907, 917-18 (6th Cir. 2000) (retiree health benefits vested despite durational limits in CBAs, which were "general durational provisions for the entire agreement, [that] are not clearly meant to include retiree benefits.").

2. *Sprague v. General Motors Corp.*, 133 F.3d 388, 400 (6th Cir 1998) (*en banc)* emphasized in the non-CBA context that "[b]ecause vested benefits are forever unalterable, and because employers are not legally required to vest them, … the intent to vest [welfare benefits] must be found in the plan documents and must be stated in clear and express language." But *Yard-Man* still is good law. *UAW v. BVR Liquidating, Inc.*, 190 F.3d 768, 772-73 (6th Cir. 1999) (finding vested retiree health benefits despite durational limitation in CBA and closure of plant).

E. Generally, however, reservation of right by the employer to amend, modify, or terminate retiree welfare benefits defeats vesting. *E.g.*, *In re Unisys Corp. Retiree Med. Benefit Litig.*, 58 F.3d 896, 904 (3d Cir. 1996); *Sprague v. General Motors Corp.*, 133 F.3d 388 (6th Cir. 1998) (*en banc*); *Chiles v. Certain Corp.,* 95 F.3d 1505 (10th Cir. 1996); *Alday v. Container Corp. of America*, 906 F.2d 660 (11th Cir. 1990).

1. In *Devlin v. Empire Blue Cross*, 274 F.3d 76 (2d Cir. 2001), *cert. denied,* 123 S. Ct. 1015 (2003), the court concluded that the reservation of rights language had to have been in the SPD when the employee was hired. Otherwise, there was no reservation of rights with respect to that employee, regardless of whether the SPD was changed before the employee retired.

III. Modification Procedure

A. Debtor makes a proposal to the retirees' authorized representative that, based upon the most complete and reliable information then available, provides for only such modifications to the pre-bankruptcy benefits plan necessary to permit the reorganization of the debtor and assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.

B. The debtor must provide the authorized representative with relevant information necessary to evaluate the proposal and must then meet and confer in good faith with the authorized representative.

C. The retirees' authorized representative must refuse to accept the debtor's proposal without good cause. The bankruptcy court must also find that the debtor's proposed modification to retiree benefits --

1. Is "necessary to permit reorganization of the debtor," and

2. Treats all parties equitable and fairly, and a balancing of the equities clearly favors such modification. 11 U.S.C. § 1114(g).

D. "Necessary to permit reorganization"

1. Interpreted very strictly in the Third Circuit almost as a "but for" test. *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074 (3d Cir. 1986).

2. The Second and Tenth Circuits have adopted a more lenient standard, requiring the debtor to demonstrate that "its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process." *Truck Drivers Local 807 v. Carey Transp., Inc.* 816 F.2d 82 (2d Cir. 1987); *Sheet Metal Workers' Int'l Ass'n, Local 9 v. Mile Hi Metal Systems, Inc. (In re Mile Hi Metal Systems, Inc.)*, 899 F.2d 887 (10th Cir. 1990).

E. The Fair and Equitable Treatment Requirement

1. Courts generally require that all parties must share in the burdens of the bankruptcy, but that the share need not be exactly equal. *In re Garofalo's Finer Foods, Inc.*, 117 B.R. 363, 370 (Bankr. N.D. Ill. 1990) ("The requirement of fair and equitable treatment under the proposal to modify does not equate with identical or equal treatment").

IV. Bankruptcy Code Amendment to Section 1114

A. The recent Bankruptcy Code amendments, which become effective next month, added a new provision to section 1114. As amended, the bankruptcy court, upon motion, may reinstate retiree benefits modified within 180 days before the Chapter 11 filing while the debtor was insolvent unless the balance of the equities clearly favors the modification.

B. This provision could hamper a company's ability to avoid section 1114 by terminating retiree benefits before bankruptcy. Not clear whether it will be used to require reinstatement of benefits modified before bankruptcy or cutback of benefits enhanced before bankruptcy.

V. COBRA Considerations

A. ERISA's COBRA provisions require that under certain circumstances, a participant or beneficiary who ceases to be covered under a group health plan is eligible to continue coverage under the plan for a period of time by electing to pay the cost of coverage, calculated using group premium rates, which are generally more favorable than premium rates for individual coverage. ERISA §§ 601, 602(3), and 604.

1. Entitlement to this so-called COBRA coverage ceases after the expiration of the period of time (ranging from 18 months to life, depending on various factors) specified in the statute, or in certain other circumstances. ERISA § 602(2). Entitlement to COBRA coverage may also cease if "the employer ceases to provide any group health plan to any employee." ERISA § 602(2)(B).

B. One of the circumstances that qualifies an individual for COBRA coverage is the cessation of retiree health coverage while the sponsoring employer is in Chapter 11. ERISA § 603(6). In such a case, the retired employee is free to elect to continue coverage under the employer's group health plan for the remainder of his or her life, and the participant's surviving spouse and dependent children may elect to continue coverage for an additional 36 months after the retiree's death. ERISA § 602(2)(A)(iii). The obligation to provide COBRA coverage ceases if the employer and its controlled group members cease to provide any group health plan to any employee.

C. The premium that may be charged for COBRA coverage is limited to 102% of the plan's cost for similarly situated participants, which does not cover the cost of benefits for this "adversely selected" group. ERISA §§ 604(1), § 602(3)(A).