

# Contractually Amendable Retiree Health and Welfare Benefits

## *Third Circuit Prevents Plan Sponsor from Terminating*

By Marshall S. Huebner and Brian M. Resnick

On July 13, 2010, in a controversial decision, the U.S. Court of Appeals for the Third Circuit ruled that a debtor must comply with the stringent procedural and substantive requirements of 11 U.S.C. § 1114 (“Section 1114”) to terminate retiree health and welfare benefits that the debtor contractually retained the right to modify at will (referred to in this article as “amendable benefits”). See *In re Visteon Corp.*, No. 10-1944, 2010 U.S. App. LEXIS 14307 (3d Cir. July 13, 2010). In a lengthy decision, the court overruled the district and bankruptcy courts, broke with the majority of courts across the country that have addressed this issue (including, most recently, in the *Delphi* case), and reached the opposite result. See, e.g., *In re Delphi Corp.*, No. 05-44481, 2009 WL 637315 (Bankr. S.D.N.Y. March 10, 2009).

The Third Circuit, however, in siding with the retirees, concluded that a plain reading of Section 1114 compels this result and reasoned that Congress likely had good cause to expand the rights of a sympathetic constituency at a time when its benefits are most vulnerable.

### SECTION 1114 Background

Section 1114 provides significant protections to retirees by setting forth requirements for modifying retiree health and welfare benefits during an employer's Chapter 11 case. The section was incorporated into Chapter 11 by the Retiree Benefits Bankruptcy Protection Act of 1988 (“RBBPA”), which Congress enacted in response to the harm and outrage arising from LTV Corporation's termination of the health and life insurance benefits of approximately 78,000 retirees during its Chapter 11 case

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without any prior notice. This action was referred to by one Congressman as “one of the most indefensible and unconscionable acts of any American corporation in this century.” LTV Bankruptcy: Hearing before the S. Comm. on the Judiciary, 99th Cong., 2d Sess. (1986) at 28 (statement of Rep. Feighan).

Although the public outcry ultimately prompted LTV to reinstate the benefits, Congress was sufficiently concerned about the potential hardship that would fall upon retirees from a unilateral termination of benefits that it enacted Section 1114, which prohibits the debtor from ceasing payments or modifying such benefits except pursuant to court order or consensual agreement with the authorized representative of the retirees. 11 U.S.C. § 1114(e)(1). “Retiree benefits” is broadly defined to include medical, surgical, hospital, sickness, accident, disability or death benefits for retirees and their spouses and dependents, and includes insurance coverage therefore. 11 U.S.C. § 1114(a). Notably, it excludes pension benefits.

In order to modify retiree benefits, the debtor must make a proposal to the authorized retiree representative “which provides for those necessary modifications in the retiree benefits that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably.” 11 U.S.C. § 1114(f)(1). Thereafter, the parties must meet and confer in good faith to reach mutually satisfactory modifications. 11 U.S.C. § 1114(f)(2). If no agreement can be reached and the authorized representative refuses to accept the debtor's proposal without good cause, the court shall order modifications so long as the requirements of Section 1114 are satisfied. 11 U.S.C. § 1114(g). In order to ensure that the debtor complies with the outcome of the Section 1114 process post-emergence, RBBPA added Section 1129(a)(13) to the list of prerequisites for plan confirmation, which requires that the plan provide for the continuing payment of all retiree benefits at the level and for the duration

established pursuant to Section 1114.

### *Applicability of Section 1114 to Amendable Benefits*

While Section 1114 unquestionably governs the modification of retiree benefits that a debtor is contractually obligated to continue to provide, a heated debate has ensued over whether Section 1114 was also intended to restrict the ability of debtors to modify amendable benefits. Compare *Retired W. Union Employees Ass'n v. New Valley Corp.* (*In re New Valley Corp.*), No. 92-4884, 1993 WL 818245 (D. N.J. Jan. 28, 1993) (holding that an employer is not required to comply with Section 1114 to modify amendable benefits), with *In re Farmland Indus., Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003) (holding that an employer is required to comply with Section 1114 to modify amendable benefits). Furthermore, the Court of Appeals for the Second Circuit in *LTV Steel Co. v. United Mine Workers (In re Chateaugay Corp.)*, 945 F.2d 1205 (2d Cir. 1991) similarly held that the interim measure mandated by RBBPA, which was applicable to cases prior to the applicability of Section 1114, required a debtor to continue paying retiree benefits during the bankruptcy case even after expiration of the CBA that mandated such benefits.

Adding to the confusion was the addition of subsection (l) in 2005, which provides that a court must reinstate benefits as of the date they were modified if the modifications were made while the debtor was insolvent during the 180-day period before the filing of the Chapter 11 petition, unless the balance of the equities clearly favors the modification. 11 U.S.C. § 1114(l). Like the rest of Section 1114, subsection (l) is silent as to whether it applies to amendable benefits, but, as described below, has led some courts and commentators to draw the inference that Section 1114 must address such benefits because those are the only benefits that a debtor could lawfully have modified prior to bankruptcy.

While the law in this area had evolved rather strongly in favor of permitting a

debtor to modify amendable benefits without complying with Section 1114 (with more than a dozen decisions in favor and only a few going the other way), the *Visteon* decision (particularly given the importance and influence of the Third Circuit) appears to have dramatically altered the playing field.

### THE VISTEON DECISION

Visteon is one of the largest automotive parts suppliers in the world and, along with its former parent Ford Motor Corporation, had provided employees with health and life insurance benefits for decades. Visteon filed for Chapter 11 on May 28, 2009, and subsequently filed a motion to terminate the retiree benefits of approximately 6,500 workers and their spouses and dependants. Over the objection of unions and retirees, the bankruptcy court granted relief and the district court affirmed. The IUE-CWA (representing approximately 2,100 workers) appealed to the Third Circuit, which held that Section 1114 unambiguously applies to all retiree benefits in Chapter 11, regardless of unilateral modification rights. In so holding, the court relied heavily on the plain language of the statute, and reasoned that, contrary to the views of other courts, the plain reading does not lead to an absurd result or one that is inexplicably contrary to fundamental principles of bankruptcy law.

#### Section 1114 Applies to Amendable Benefits

The court found that the plain language of the statute compels the conclusion that Section 1114 applies to amendable benefits. The Third Circuit relied on the broad language in Section 1114(e)(1), which states that “[notwithstanding] any other provision of this title, the [trustee] shall timely pay and shall not modify any retiree benefits,” except by complying with the procedural requirements of the section. 11 U.S.C. § 1114(e)(1) (emphasis added). In the court’s view, these words (and the definition of “retiree benefits”), without any qualification, could hardly be more clear — “any” means any.

The court was unpersuaded by the argument (adopted by the court in *In re New Valley Corp.*) that Section 1129(a)(13) exemplifies the ambiguity in Section 1114 by requiring debtors to continue benefit payments after bankruptcy at the level established pursuant to Section 1114 only “for the duration of the period the debtor has obligated itself to provide such benefits.” 11 U.S.C. § 1129(a)(13). Rather, the court found support for its view that Section 1114 was intended to apply to amendable benefits in the absence in Section 1114 of the durational qualifying language found in Section 1129(a)(13).

Furthermore, while the *Delphi* court found the addition of subsection (l) in 2005 unrevealing as to the intended breadth of Section 1114, the Third Circuit in *Visteon* cited its addition as further evidence of Congress’s intent to make the section broadly applicable. Like the rest of Section 1114, subsection (l) is silent as to

whether it applies to amendable benefits, but the Third Circuit reasoned that its protections would be virtually meaningless if it did not because the debtor was already prohibited by law from modifying any other benefits prior to bankruptcy. The court found the analysis of the *Delphi* court — that it is plausible that this subsection was intended to apply to pre-bankruptcy breaches of vested rights by debtors in financial distress — strained.

Finally, although there were several statements in the legislative history referring to the concern that companies keep their promises made to employees, the court found these statements insufficient to justify a departure from what it saw as the unambiguous plain language of the statute. Additionally, there were numerous statements made by legislators suggesting that Congress’s concern was broader, in that they were trying to protect the legitimate expectations of the former workers, which could presumably encompass amendable benefits as well. In the court’s view, it was irrelevant that in 2007 Congress considered, but did not pass, legislation that would have explicitly provided that Section 1114 applies to amendable benefits. A plausible explanation for the bill’s failure, the court figured, was that Congress determined that the existing statute was unambiguous and needed no clarification.

#### Reading Section 1114 to Apply To Amendable Benefits Does Not Lead to an Absurd Result

Perhaps the most significant point of disagreement between the opposing views on this issue is whether the plain reading of the statute leads to an absurd result because it gives retirees substantially greater rights in bankruptcy than they would have outside bankruptcy. The *Delphi* court presumed that Congress was cognizant of two fundamental principles of bankruptcy law when enacting Section 1114 - 1) a third party’s rights should not be improved by the debtor’s bankruptcy filing (in fact the court could not identify any other provision of the Bankruptcy Code that improves the prepetition contractual rights of a third party as a result of the debtor’s bankruptcy filing); and 2) because bankruptcy is a zero sum game, statutory priorities should be narrowly construed. In the absence of legislative history clearly indicating Congress’s intention to override these principles, the *Delphi* court declined to read Section 1114 (which it found ambiguous) in such a manner.

The Third Circuit took strong issue with that analysis. In enacting ERISA, Congress intentionally determined that to require the vesting of retiree health and welfare benefits (like pension benefits) would likely result in employers choosing not to provide the benefits at all. The prevailing sentiment among many legislators (particularly in light of *LTV*) was that ERISA’s lack of protections for retiree benefits imposed significant hardship on elderly recipients. With some legislators favoring a

massive expansion of ERISA’s protections to cover retiree welfare benefits, and others opposed, the court speculated that RBBPA was an imperfect legislative compromise — a move aimed at addressing certain deficiencies in the protection of retiree benefits because more substantial changes would not garner enough Congressional support or because more protections are yet to come.

Though other courts struggled to find the logic in mandating that plan sponsors in bankruptcy be required to comply with Section 1114 to modify amendable benefits, the Third Circuit reasoned that this was precisely the time period when such benefits were most vulnerable. It reasoned that the market forces that restrain employers from exercising their rights to terminate benefits in good times are replaced in bankruptcy with intense cost-cutting pressures from creditors and prospective financiers. To be sure, debtors are entirely free to modify amendable benefits upon emergence from bankruptcy, but at least during the period when the benefits are most likely to be terminated (during bankruptcy), the *Visteon* court found that debtors must seek to do so in compliance with Section 1114. Importantly, the court expressed the view that in weighing the equities in connection with a debtor’s request to impose modifications in accordance with Section 1114, the court should consider whether the debtor has reserved the right to unilaterally modify the benefits.

### CONCLUSION

Ultimately, the court characterized the protections of Section 1114 as guaranteeing retirees “a voice, and some minimal amount of leverage, in a process that could otherwise be nothing short of devastating to them and to their families and communities.” *Visteon* at 75-76. Given the unique vulnerability of retiree benefits in bankruptcy and the catastrophic consequences to covered individuals whose benefits are terminated, the Third Circuit found it unsurprising that Congress would single out retirees as arguably being the only constituency to fare better in bankruptcy than outside.

The Third Circuit’s decision could prove costly to debtors with significant retiree benefit liabilities. As a practical matter, at least in the Third Circuit and any other jurisdiction that follows suit, debtors will likely continue to pay amendable benefits at least until emergence. At the very least, this decision greatly increases the bargaining power of retirees. Therefore, prospective debtors concerned about the costs of retiree benefits in bankruptcy may end up deciding to terminate amendable benefits more than 180 days before filing for bankruptcy.

