The *Visteon* Decision: Third Circuit Expands Section 1114 Protections to Terminable-at-Will Retiree Benefit Plans

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On July 13, 2010, the United States Court of Appeals for the Third Circuit issued an opinion in the chapter 11 case of Visteon Corporation ("Visteon"), holding that the procedures set forth in section 1114 of the Bankruptcy Code apply to all retiree benefit plans, even those plans that could have been terminated at will outside of bankruptcy. In so ruling, the Third Circuit reached the opposite conclusion on this issue from the majority of courts that have previously considered it. As a result, debtors in the Third Circuit will need to give more careful consideration to approaches to terminating or modifying their retiree benefit plans either before filing for or while in bankruptcy.

Background

Visteon is one of the world's largest suppliers of automotive parts. Originally a division of Ford Motor Corporation, it was spun off as an independent entity in 2000. In connection with its operations, Visteon had provided certain health and life insurance benefits to its retirees. Pursuant to the relevant governing documents for these retiree benefit plans, Visteon retained the right to modify or terminate the plans at any time.

Visteon filed for chapter 11 protection on May 28, 2009, in Delaware. On June 26, 2009, Visteon moved the bankruptcy court for permission to terminate all of its domestic retiree benefit plans. Visteon did not ask for authority to terminate these plans pursuant to section 1114 of the

Bankruptcy Code, which (as described below) requires extensive procedures to be followed in order to modify or terminate retiree benefits. Instead, Visteon asked for authorization under section 363 of the Bankruptcy Code, which in essence requires only a showing of the debtor's reasonable exercise of business judgment.

Several groups of retirees and their unions objected to Visteon's motion to terminate benefits on the ground that Visteon needed to comply with the requirements of section 1114. The bankruptcy court overruled those objections, following the view of the majority of courts that have previously addressed the issue, and allowed Visteon to terminate the retiree benefit plans without following the procedures set forth in section 1114. The bankruptcy court reasoned that because the benefit plans could be terminated at will outside of bankruptcy, it would be "absurd" to expand retirees' rights inside bankruptcy by applying the procedures of section 1114 when there existed no legitimate bankruptcy purpose for doing so in the context of nonvested retiree benefits.

The retirees appealed the bankruptcy court's decision to the Delaware district court. The district court affirmed the decision, reasoning that if Visteon were required to follow the procedures set forth in section 1114 for a plan that it was free to terminate outside of bankruptcy, the situation would result in a "unique if not revolutionary interpretation of the Bankruptcy Code by improving prepetition, contractual rights of a third party constituent as a result of the filing of a bankruptcy case."

The retirees then further appealed the district court's decision to the Third Circuit.

The Third Circuit's Decision

On appeal, a three-judge panel of the Third Circuit reversed the lower courts' decisions and held that Visteon was required to follow the procedures set forth in section 1114 of the Bankruptcy Code to terminate its retiree benefit plans, even those that Visteon had the right to terminate at will outside of bankruptcy.

Plain Language of Section 1114

In beginning its analysis on the issue of whether section 1114 applied to Visteon's termination of its nonvested retiree benefit plans, the Third Circuit looked at the text of the statute itself. On its face, section 1114(e) of the Bankruptcy Code provides that a debtor "shall timely pay and shall not modify *any retiree benefits*" (emphasis added), except through the procedures set forth in the statute or by agreement with the affected retirees.

Retiree benefits covered by section 1114 include benefits to retired employees and their spouses and dependents for medical, surgical, or hospital-care benefits or for benefits in the event of sickness, accident, disability, or death under any plan maintained or established by the debtor prior to bankruptcy. The procedures in section 1114 require the debtor to provide certain information to, and negotiate with, the retirees regarding the modification or termination of benefits. If the debtor and the retirees are unable to reach agreement, then the debtor must make a showing to the court that the modification or termination of benefits is necessary for reorganization, treats all affected parties fairly and equitably, and is favored by the balance of equities.

The Third Circuit concluded that the language in section 1114 is plain and unambiguous and requires a debtor to follow the procedures for the modification or termination of *any* retiree

benefits—even benefits that are terminable at will outside of bankruptcy. The court noted that there are no exceptions or limitations on section 1114's application, and benefits that are terminable at will fit into its broad definition.

The court rejected Visteon's argument that section 1114 is ambiguous when read in conjunction with section 1129(a)(13) of the Bankruptcy Code. Section 1129(a)(13), which was enacted at the same time as section 1114, states that in order to obtain confirmation of a chapter 11 plan, a debtor must continue to provide retiree benefits "for the duration of the period that the debtor has obligated itself to provide such benefits." Visteon, following the reasoning of other courts, argued that sections 1114 and 1129 are meant to be read together, and thus section 1114's application should be limited to retiree benefits that the debtor is obligated to provide until such time that the debtor has the unilateral right to terminate the benefits. The Third Circuit found this argument unpersuasive and concluded instead that Congress meant to differentiate between the two provisions, such that section 1114 applies to *all* retiree benefits regardless of the duration of the obligation.

The Third Circuit panel also cited to a 2005 amendment to section 1114 as evidence of the broad scope of the statute. Specifically, section 1114(l) was added in 2005 to provide parties in interest with the right to seek a court order restoring retiree benefits that were terminated or modified by an insolvent debtor in the 180-day period prior to the bankruptcy filing. The Third Circuit noted that not only does section 1114(l) apply to *all* retiree benefits, with no limit for benefits that are terminable at will, but also that the provision would be virtually meaningless if it did not apply to

those benefits that the debtor could unilaterally terminate or modify, because that is effectively the only way such a termination or modification could occur prior to a bankruptcy filing.

Legislative History

The Third Circuit also examined the legislative history of section 1114 to aid in its interpretation of the statute. Section 1114 and section 1129(a)(13) were the primary substantive components of the Retiree Benefits Bankruptcy Protection Act of 1988 ("RBBPA"). Congress enacted RBBPA in direct response to LTV Corporation's termination of health and life insurance benefits to 78,000 retirees during its chapter 11 bankruptcy case in the mid-1980s. According to the legislative history, while the principal objectives of chapter 11 after the enactment of this legislation would remain the facilitation of a debtor's reorganization and the protection of creditors' interests, the purpose of section 1114 is to protect the interests of retirees of chapter 11 debtors.

Visteon cited to certain statements in the legislative history of RBBPA to argue that Congress intended to protect only vested benefits that are "legal and contractual obligations" that could not be terminated at will. But the Third Circuit cited to numerous other comments in the legislative record to make the point that Congress intended to protect "legitimate expectations" of retirees for benefits, including those benefits that were otherwise terminable. The court concluded that Congress was well aware that many retiree benefits are terminable at will, but it nonetheless wanted to protect all such retiree benefits while a company is in bankruptcy by subjecting them to the requirements of section 1114. In the Third Circuit panel's view, Visteon fell woefully short of the "extraordinary showing of contrary intentions" in the legislative history to justify a

departure from the unambiguous plain language of section 1114 and its application to *all* retiree benefits.

Not an "Absurd Result"

Finally, the Third Circuit addressed the argument by Visteon that giving retirees more rights in chapter 11 through the protections set forth in section 1114 than they had outside of bankruptcy is such an absurd result that Congress could not have intended so much. The Third Circuit concluded that giving retiree benefits extra protection in bankruptcy is not an absurd result at all, but rather a reasonable compromise that Congress could have reached to provide at least some procedural protections for retiree benefits when they are at their most vulnerable—during a company's bankruptcy.

In this regard, the court traced the history of the federal legislative treatment of retiree compensation, including the fact that the Employee Retirement Income Security Act ("ERISA") protects pension benefits for retirees, with elaborate vesting requirements for pension plans, but has no such vesting requirements for welfare benefit plans for retirees. While certain legislators would have preferred to amend ERISA to require vesting for retiree benefit plans, the court noted, Congress did not go that far. Rather, lawmakers agreed to install procedural safeguards for modifying or terminating benefits while a company is in bankruptcy. The Third Circuit reasoned that a chapter 11 case is a logical time to require such safeguards because bankruptcy can distort a company's normal decision-making process and expose retiree benefits to extra risk. For example, a company is less likely to modify retiree benefits during good financial times because such benefits help attract and retain employees. In bankruptcy, however, a debtor faces intense

pressure to relieve itself of ongoing and future liabilities, and as a result, it may attempt to shed liabilities, such as retiree benefits, that it ordinarily would be inclined to stand behind.

Accordingly, the Third Circuit determined that it is not an "absurd" result that Congress wished to provide extra protection for retiree benefits when a company is in bankruptcy and those benefits are most vulnerable. Rather, the court concluded, such a result is a "measured middle-ground" that allows a company some flexibility in modifying retiree benefits, subject to procedural safeguards that provide at least some level of protection for those benefits when they are most needed.

Future Planning

As described above, the Third Circuit's decision in *Visteon* goes against the majority of courts that have considered the application of section 1114 to retiree benefit plans that are terminable at will. Given its thorough analysis of the issue and legislative history, however, the opinion may be persuasive precedent for courts in other circuits.

In the future, debtors (especially those in the Third Circuit) will need to be aware of this decision, including the requirement it imposes on debtors to go through the section 1114 process to modify or terminate retiree benefit plans, even those that are terminable at will. Although it does not prohibit a debtor from modifying or terminating retiree benefits, section 1114 does require that the debtor negotiate with retirees and, absent agreement, make certain showings to the court as to why such modifications or terminations are needed. It bears adding, however—as the Third Circuit panel also made clear—that a debtor remains free to terminate benefits as permitted by its retiree welfare plan after the debtor emerges from bankruptcy.

At a minimum, though, the Third Circuit's *Visteon* decision will give retirees and their unions more leverage in chapter 11 cases and require debtors to give more consideration to these constituencies in the future.

IUE-CWA v. Visteon Corp. (In re Visteon Corp.), 612 F.3d 210 (3d Cir. 2010).