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In re Visteon Corp.: Contractual Modification of Retiree Benefits Subject to § 1114

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Section 1114(e) of the Bankruptcy Code requires "timely" payment of "retiree benefits" post-petition and prohibits modification of such benefits absent compliance with procedures set forth in §§ 1114(f)-(h). The term "retiree benefits" is defined by § 1114(a) as health, disability or life insurance "payments...under any plan, fund or program...maintained or established in whole or in part by the debtor" pre-petition.


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Section 1114 was enacted as part of the Retiree Benefits Bankruptcy Protection Act of 1988 (RBBPA), in response to LTV Corporation's termination of health and welfare benefits of 78,000 retirees during its 1986 chapter 11 case.[1] The effect of § 1114 would seem straightforward—*i.e.*, if the debtor is obligated to provide health and welfare benefits to retirees under a pre-petition agreement, the debtor must continue to do so post-petition absent modification of such obligation in accordance with the statutory procedures.[2] A question arises, however, when the agreement permits the debtor unilaterally to modify benefits. The question is, does § 1114 impact the debtor's exercise of its contractual right to modify, or does it merely preclude the debtor from breaching the agreement post-petition, by compelling the debtor's continued performance absent compliance with the statutory procedure for modification?


Robert S. Brady

Bankruptcy and district courts have reached divergent conclusions, sometimes within the same district.[3] Those courts taking the "plain language" approach find it "clear beyond peradventure of a doubt" that § 1114 applies, based on the plain language of the statute defining "retiree benefits" broadly to include all payments under a pre-petition plan, fund or program.[4] Others applying a "contextual approach" find § 1114 ambiguous as to its intended scope. The "contextual approach" courts read the statute narrowly in context with other provisions of the Code, legislative history and normative bankruptcy principles to conclude that § 1114 was not intended to enhance retirees' rights under applicable non-bankruptcy law.[5]


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Practice & Procedure

In its July 13, 2010, opinion in *In re Visteon Corp.*,[6] a Third Circuit panel sided unanimously with the "plain language" courts and criticized the courts applying a contextual approach to § 1114. What follows is a discussion of the contextual approach to § 1114, the Third Circuit's criticism thereof and some planning considerations in the wake of the *Visteon* ruling.

Contextual Approach to § 1114

Courts applying a contextual approach take as their starting point two fundamental principles of bankruptcy law. *First*, pre-petition contract rights should not be expanded or improved

1 *In re Chateaugay Corp.*, 922 F.2d 86, 88-89 (2d Cir. 1990).

2 *In re Chateaugay Corp.*, 945 F.2d 1205, 1210 (2d Cir. 1991) ("[RBBPA] requires that companies in Chapter 11 bankruptcy continue to provide benefits to retired employees in conformity with the plan or fund in existence at the time bankruptcy was declared.").

3 *Compare In re Ames Dep't Stores Inc.*, 1992 U.S. Dist. LEXIS 18275, *4 (S.D.N.Y. Nov. 30, 1992) (§ 1114(e) applies notwithstanding debtor's contractual right to modify), *vacated on other grounds*, 76 F.3d 66 (2d Cir. 1996); *with In re Delphi Corp.*, Case No. 05-44481 (RDD), 2009 Bankr. LEXIS 576, *19 (Bankr. S.D.N.Y. March 10, 2009) (§ 1114(e) does not apply where debtor reserves contractual right to modify).

4 *See In re Ames Dep't Stores*, 76 F.3d 66, 69 (2d Cir. 1996) (*quoting* from Bankr. S.D.N.Y. ruling earlier in proceeding); *accord In re Farmland Indus.*, 294 B.R. 903, 914 (Bankr. W.D. Mo. 2003).

5 *Delphi Corp.*, 2009 Bankr. LEXIS 576 at *19; *In re N. Am. Royalties Inc.*, 276 B.R. 860, 867 (Bankr. E.D. Tenn. 2002); *In re Doskocil Cos.*, 130 B.R. 870 (Bankr. D. Kan. 1991).

6 No. 10-1944, 2010 U.S. App. LEXIS 14307 (3d Cir. July 13, 2010).

solely as a result of a debtor's bankruptcy filing. *Second*, statutory priorities should be narrowly construed. Because Congress is presumed to have been aware of these principles when amending the Bankruptcy Code, courts are reluctant to interpret § 1114 in a manner that expands the pre-bankruptcy rights of retirees at the expense of other creditors if such expansion was not the subject of at least some discussion in the legislative history.[7] Looking to the legislative history, however, the courts find that § 1114 was passed to address debtors' unilateral termination of benefits using the provisions of the Code, and not to address debtors' exercise of pre-existing contractual rights.[8] Courts find additional support for a narrow reading of § 1114 in other provisions of the Code.

Section 1113(b) and (c) establishes a negotiating procedure to be completed before the court considers an application by the debtor to modify the terms of a collective-bargaining agreement (CBA). The standard for modification of a CBA under § 1113 was adopted by RBBPA and codified in § 1114. Because § 1113 applies to modification of a debtor's *legal* obligations, and nothing in § 1114 suggests that it was intended to operate on claims for which the debtor had no legal liability, it seems improbable that Congress would have adopted the same standard for § 1114 as prescribed for modification of agreements under § 1113. Accordingly, courts infer that Congress intended § 1114 to focus primarily on the modification of debtor's *contractual* obligations to retirees, as opposed to imposing on the debtor some new obligation not already provided by the benefit plan.[9]

Section 1129(a)(13) requires a chapter 11 plan to provide for the continuation and payment of all retiree benefits "at the level established pursuant to [§ 1114(e)(1)(B) or (g)]...*for the duration of the period the debtor has obligated itself to provide such benefits.*" (emphasis added). Because § 1129 ties the post-confirmation rights of retirees expressly to the terms of the benefit plan, courts find it unusual that § 1114 would give broader rights to retirees for the limited period post-petition, pre-confirmation. This is especially so given that the Employee Retirement Income Security Act (ERISA), which allows a contract for retiree welfare benefits to provide the employer a right to terminate, contains no such protection. Rather than read §§ 1114 and 1129 in tension with one another, the courts harmonize them by taking the view that "each recognizes that the debtor's obligations under retiree benefit plans that are modifiable at will are qualified by a right under non-bankruptcy law to modify or terminate."[10] Finding that § 1114 does not govern where a benefit plan permits unilateral modification by the debtor, the courts conclude that modification post-petition is governed by the "business judgment" standard of § 363.[11]

The Visteon *opinion is the first circuit-level opinion squarely addressing the application of § 1114 issue of terminable-at-will benefits and, absent reversal* en banc, *lends credence to the heretofore minority interpretation of § 1114 and requires debtors' counsel in any jurisdiction to look at retiree benefits with a fresh set of eyes.*

Background

In May 2009, Visteon Corp. filed for chapter 11 relief in the U.S. Bankruptcy Court for the District of Delaware. Shortly thereafter, Visteon filed a motion pursuant to § 363(b)(1) of the Code, seeking permission to terminate all U.S. retiree benefits plans. Visteon's request was opposed by several groups of retirees, who argued that Visteon could not terminate retiree benefits without first complying with § 1114.[12]

Finding that Visteon had the right under non-bankruptcy law to terminate the retiree benefits unilaterally, the bankruptcy court concluded that § 1114 did not apply and approved the termination of the retiree benefits under § 363(b)(1) as a reasonable exercise of Visteon's business judgment. In reaching its conclusion, the court incorporated by reference the reasoning of the *Delphi* court and expressly rejected the "plain-meaning" analysis of the *Farmland Industries* court as "lead[ing] to an absurd result in that it would expand retiree rights beyond the scope of state law for no legitimate bankruptcy purpose."[13]

The retirees later moved for a stay pending appeal of the order permitting termination of the benefits programs. Although the bankruptcy court found that some Medicare-ineligible retirees faced irreparable harm, it denied the stay because it concluded they were not likely to prevail on appeal. The district court affirmed the bankruptcy court's ruling, but, noting the absence of Circuit or Supreme Court authority on point, granted a limited stay of the order to permit the retirees to seek an expedited appeal.[14]

Third Circuit Ruling

The Third Circuit framed the issue on appeal as to whether the plain language of § 1114 encompasses all retiree benefits, including those that are terminable at will by the debtor. The court then summarized the majority view in the case law, relied upon by the lower courts, as follows:

> [R]estricting a debtor from terminating during bankruptcy those retiree benefits that it could otherwise terminate at will is absurd, and courts must conclude that the plain language of a statute does not reflect congressional intent if it produces an absurd result.[15]

Having characterized the majority view as completely dependent on a finding of "absurdity,"[16] the Third Circuit went on to conclude that the majority courts "mistakenly relied on their own views about sensible policy, rather than on the congressional policy choice reflected in the unambiguous language of the statute."[17] For its part, the Third Circuit found that (1) § 1114 is unambiguous and clearly applies to any and all retiree benefits, and (2) application of § 1114 to terminable-at-will benefits (a) is consistent with legislative intent, and (b) does not produce "absurd" results.

On the first point, the court found that benefits "the debtor *could* have terminated outside of bankruptcy, but which it was nonetheless providing at the time of its Chapter 11 filing, are plainly included in the phrase, 'payments to any entity or person...under

7 *Delphi Corp.*, 2009 Bankr. LEXIS 576 at *7-10.
8 *See Doskocil Cos.*, 130 B.R. at 874-876.
9 *Doksocil Cos.*, 130 B.R. at 876.
10 *Delphi Corp.*, 2009 Bankr. LEXIS at *15-17; *see N. Am. Royalties*, 276 B.R. at 867.
11 *N. Am. Royalties*, 276 B.R. at 866.
12 *Visteon Corp.*, 2010 U.S. App. LEXIS 14307 at *1-6.
13 *Id.* at *7-10.
14 *Id.* at *10-12; *In re Visteon Corp.*, Civ. Act. No. 10-91, 2010 U.S. Dist. LEXIS 35896, *10-11 (D. Del. Apr. 7, 2010).
15 *Visteon Corp.*, 2010 U.S. App. LEXIS 14307 at *22.
16 The authors note that, among the courts applying the contextual approach to § 1114, only the *Visteon* bankruptcy court expressly found that application of § 1114 to terminable-at-will benefits would be "absurd."
17 *Visteon Corp.*, 2010 U.S. App. LEXIS 14307 at *24-25.

any plan, fund or program.'"[18] The court noted that § 1114 is limited to certain types of benefits maintained or established pre-petition, and § 1114(m) excludes benefit payments to high-income retirees. However, there is no similar limitation of § 1114 to benefits the debtor is otherwise compelled to provide, or exclusion of benefits that are terminable at will. Given the breadth of the statutory language, the court found that its silence as to the specific issue of terminable-at-will benefits was irrelevant.[19] The court went on to consider the Second Circuit's decision in *LTV Steel Co. Inc. v. United Mine Workers of America (In re Chateaugay Corp.)*,[20] which addressed the "distinct but related issue of whether [RBBPA] required a debtor to continue paying retiree benefits during bankruptcy even after expiration of the applicable CBA."[21]

The *Chateaugay* court held that the statutory language "under any plan, fund or program" compels judicial consideration of the plan under which benefits are being provided, to determine which benefits, if any, are due. Because the debtor in *Chateaugay* was not obligated to continue paying benefits upon expiration of the CBA, a split panel of the Second Circuit reasoned that no further payments were necessary under RBBPA. The dissent in *Chateaugay* found that because RBBPA was not limited to "obligations" of a debtor or payments "required" under a plan, it applied to any benefits that were being provided under a plan that was in effect as of the petition date.[22] The Third Circuit sided with the *Chateaugay* dissent in principle, but found the case inapposite because it dealt with the natural expiration of a benefits contract rather than its modification post-petition.[23]

The court next considered the apparent tension between § 1114 and its counterpart § 1129(a)(13) discussed above. The court found that the presence of a durational limitation in § 1129(a)(13) and its absence in § 1114 simply indicated Congress's intent to continue all retiree benefits during the bankruptcy case "when they are most vulnerable," even if the debtor would not otherwise be obligated to continue them.[24]

The court found further support for this interpretation in § 1114(l), which requires the bankruptcy court, on motion of a party in interest, to reinstate benefits terminated within 180 days pre-petition and while the debtor was insolvent, unless the court finds that the balance of the equities clearly favors such modification. The court noted that § 1114(l) is not expressly limited to benefits that the debtor is obligated to continue to provide, and found that interpreting it in such a limited fashion would render it "virtually meaningless" because other provisions of federal and state law already prohibit the modification of vested benefits.[25]

The court turned next to the legislative history of RBBPA to determine whether the "plain meaning" approach to § 1114 would lead to results demonstrably at odds with congressional intent. To the contrary, the court concluded that the available legislative history evidenced a broad legislative concern about the legitimate expectations of retirees and the moral obligation to treat them fairly in a chapter 11 reorganization.[26]

Turning to the "absurdity" of the application of § 1114 to terminable-at-will benefits, the court found that mere conflict with fundamental bankruptcy principles was "far too low a bar" for "absurdity" as a matter of statutory construction. After a discussion of how retiree benefits are treated under ERISA, the court posited that the RBBPA may well have been a partial legislative response to growing concerns that retiree benefits were not receiving enough protection under existing law. Against this backdrop, the court concluded that § 1114 "can be seen as affording additional protection to retiree benefits just as legal and economic pressures converge to encourage a debtor to terminate benefits based on short-term considerations with insufficient regard for long-term consequences to retirees or to the debtor itself."[27]

Additionally, the court noted that the protections afforded by § 1114 are temporary and terminate upon plan confirmation, because § 1129(a)(13) "ensures that a debtor who reserved the right to terminate retiree benefits has no ongoing obligation, other than one that may have been voluntarily undertaken during the § 1114 process, to continue to provide benefits." Thus, the court concluded that § 1114 is "neither entirely nor permanently in derogation of underlying contractual rights," but merely "guarantees 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." Accordingly, the court concluded that the doctrine of "absurdity" was "entirely inapplicable."[28]

Planning Considerations

The *Visteon* opinion is the first circuit-level opinion squarely addressing the application of § 1114 issue of terminable-at-will benefits and, absent reversal *en banc*,[29] lends credence to the heretofore minority interpretation of § 1114 and requires debtors' counsel in any jurisdiction to look at retiree benefits with a fresh set of eyes. *Visteon* argued to the Third Circuit that reversal of the bankruptcy court's order would "prompt any rational soon-to-be debtor to terminate retiree benefits on the eve of bankruptcy." The Third Circuit disagreed, stating that Congress anticipated this "escape hatch" and closed it with the addition of § 1114(l), which the court described as "prohibit[ing] an insolvent debtor from terminating retiree benefits in the six months prior to filing for bankruptcy."[30]

Despite the Third Circuit's characterization of § 1114(l), the statutory language does not prohibit modification of retiree benefits pre-petition. Rather, it provides a procedural mechanism whereby a party may seek post-petition to reinstate retiree benefits as they existed prior to the modification. The authors believe this is a distinction with a significant difference, because § 1114 provides different standards for approval of post-petition and pre-petition modifications of retiree benefits. To wit, post-petition modifications must be "necessary to permit the reorganization of the debtor" pursuant to § 1114(f)(1)(A) and (g)(3), whereas a pre-petition modification will stand under § 1114(l) so long as "the balance of the equities clearly favors such modification." Given the difference between these legal standards, a rational soon-to-be debtor should at least consider the relative advantages and disadvantages of modifying pre-petition, with the possibility of defending against a § 1114(l) motion, versus entering chapter 11 with the retiree benefits intact and complying with the negotiating procedure of § 1114(f)-(h).

Additionally, though not strictly speaking a "planning consideration," it is important to note that the relative

18 *Id.* at *26 (emphasis in original, quoting 11 U.S.C. § 1114(a) (definition of "retiree benefits")).
19 *Id.* at *27-29.
20 945 F.2d 1205 (2d Cir. 1991).
21 *Visteon Corp.*, 2010 U.S App. LEXIS 14307 at *30.
22 *Chateaugay*, 945 F.2d at 1207, 1209-10 (majority opinion) and 1211-13 (Restani, J., dissenting).
23 *Visteon Corp.*, 2010 U.S. App. LEXIS 14307 at *32 and n.16.
24 *Id.* at *35-41.
25 *Id.* at *41-43.
26 *Id.* at *46-61.
27 *Id.* at *61-73.
28 *Id.* at *75-80.
29 Visteon filed a petition for rehearing *en banc* on July 27, 2010.
30 *Visteon Corp.*, 2010 U.S. App. LEXIS 14307 at *34 n.17.

leverage points between a debtor and its retirees is not materially altered by the Third Circuit's decision. Even under the plainest reading of *Visteon*, a debtor can unilaterally modify retiree benefits immediately post-confirmation in accordance with the agreement's terms and § 1129(a)(13). Consequently, if modification of benefits is not a viable option pre-petition or pre-confirmation, but is critical to the long-term viability of the debtor's business, the debtor will still have unilateral modification as an avenue upon emergence. The issue then becomes whether the debtor can afford the § 1114-mandated benefits during the course of its case. While the rehearing *en banc*, if granted, may ultimately render this discussion moot, the *Visteon* decision likely will have more of an effect on timing, strategy and planning of bankruptcy proceedings than on debtors' long-term business strategies. ■

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