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Case Study: In Re Visteon Corp.

Law360, New York (August 12, 2010) -- In a recent and monumental holding in the bankruptcy proceedings of Visteon Corporation, IUE-CWA v. Visteon Corp. (In re Visteon Corp.), the Third Circuit Court of Appeals provided retired benefit recipients stronger leverage and additional protections than those previously recognized by a majority of courts.

On July 13, 2010, the Third Circuit ruled that, under the Bankruptcy Code, § 1114, during the limited period of a bankruptcy proceeding, a debtor cannot modify any retiree benefits, even if the debtor would not otherwise be obligated to continue the benefits, except as provided by Section 1114.[1]

The Third Circuit's ruling reflects the minority position in its application of Section 1114, and the result presents a unique situation where certain creditors, the retirees, are afforded better treatment during a bankruptcy proceeding than they would have been treated under applicable nonbankruptcy law.

The Third Circuit handed down this controversial holding just over a year after Judge Robert Drain for the United States Bankruptcy Court for the Southern District of New York addressed the same issue and entered a heavily contested decision in the Delphi Corporation bankruptcy, which affected approximately 15,000 employees.

In Delphi Corporation, Judge Drain sided with the majority of courts addressing this issue, and held that if the prepetition plan documents governing the retiree benefits gave the debtor the unilateral right to modify the benefits, then Section 1114 did not abrogate the debtor's rights by requiring compliance with the provisions of Section 1114.[1]

However, Judge Drain held that the prerequisite to allowing the debtor to modify or terminate a health or welfare plan without compliance with Section 1114, as the exercise of its rights under nonbankruptcy law, is that the debtor must "make a significant showing that it, in fact, has such a unilateral right and that the benefits are not vested."[3]

Background of Visteon

Visteon is one of the world's largest automotive suppliers, and for decades Visteon, or its predecessors-in-interest, Ford Motor Corporation or its subsidiaries, provided its retired employees with health and life insurance benefits.

Visteon filed its petition for relief under Chapter 11 of the Bankruptcy Code on May 28, 2009, and shortly thereafter Visteon requested permission to terminate all United States retiree benefit plans pursuant to 11 U.S.C. § 363(b)(1). This request affected 8,000 present and former employees, along with their spouses and families.

Numerous groups of retirees, including those represented by the IUE-CWA, objected and argued that Visteon could not terminate any retiree benefits without first complying with the requirements of Section 1114.

Both the bankruptcy court and the district court held that it would be unreasonable to interpret Section 1114 as preventing a debtor from modifying or terminating benefits during the pendency of a Chapter 11 bankruptcy proceeding, if the debtor could unilaterally terminate such benefits outside of bankruptcy pursuant to the benefit plan.[4] The Third Circuit reversed the district court's opinion and remanded the matter for further proceedings.

Bankruptcy Code, § 1114

In order to examine the implications of the Visteon ruling and to analyze the Third Circuit's minority interpretation of Section 1114, it is first necessary to review the plain language of Bankruptcy Code, Section 1114.

Section 1114(a) defines "retiree benefits" as "payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise) maintained or established in whole or in part by the debtor prior to filing a [bankruptcy] petition ..."[5]

Section 1114(e)(1) provides that the debtor-in-possession, or the trustee if one has been appointed[6], "shall timely pay and shall not modify any retiree benefits, except that (A) the court, on motion of the trustee or authorized representative, and after notice and a hearing, may order modification of such payments, pursuant to the provisions of subsections (g) and (h) of the section, or (B) the trustee and the authorized representative of the recipients of those benefits may agree to the modification of such payments, after which such benefits as modified shall continue to be paid by the trustee."[7]

Section 1114 (g) requires as a prerequisite to any court-ordered modification, that the debtor-in-possession or trustee, as applicable, have made a proposal for modification that complies with the requirements of Section 1114(f).

Section 1114(f)(1)(A) requires that prior to asking a court to modify retiree benefits, the trustee must first attempt to reach an agreement with the authorized representative of the retirees, and any proposed modification must be "necessary to permit the reorganization of the debtor that assures that all creditors, the debtor and the affected parties are treated fairly and equitably."[8]

Sections 1114(f)(1)(B) & (f)(2) also require that the trustee provide the debtor's financial information to "allow for [an] informed evaluation of the proposal" and that the trustee meet with the authorized representative of the retirees to "confer in good faith."

After the trustee satisfies the requirements in Section 1114(f), in order to permit the modification of the retiree benefits, the court must make a finding that the authorized representative refused to accept the offer made under Section 1114(f) without "good cause," and that the proposed modification "is 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, and is clearly favored by the balance of the equities."[9]

Analysis of the Visteon Ruling

The Third Circuit narrowly tailored the issue on appeal, as follows: whether Section 1114 limits a debtor's ability to terminate during bankruptcy those retiree benefits that it could terminate unilaterally outside of bankruptcy.[10]

Visteon and the committee of unsecured creditors ("Unsecured Creditors") argued that restricting a debtor from terminating during bankruptcy those benefits that it could otherwise terminate at will outside of bankruptcy is absurd, and that the statute does not reflect congressional intent if it produces an absurd result.[11]

The Third Circuit rejected this argument. In its analysis, the Third Circuit focused on the legislative history of Section 1114 and the plain language of the statute.

Section 1114 and its counterpart, 11 U.S.C. § 1129(a)(13), were the main substantive components of the Retiree Benefits Bankruptcy Protection Act of 1988 ("RBBPA"). Congress enacted RBBPA in response to the bankruptcy case of LTV Corporation, in which the debtor terminated, without notice, health and life insurance benefits of 78,000 retirees.[12]

The court noted that neither Visteon nor the Unsecured Creditors were able to point to any legislative history suggesting that the protections provided by Section 1114 only applied when the debtor is legally or contractually obligated to provide benefits.[13]

Rather, the court noted the well-documented concerns after the LTV Corporation incident: that retirees who devoted their working lives to a business deserved payment of their retiree benefits to the fullest extent possible in a reorganization, and retirees should not bear the burden of a company reorganizing.

The court also looked to testimony provided in hearings related to the LTV Corporation bankruptcy, which clearly indicated that while a debtor is attempting to reorganize, it faces internal and external pressure to "relieve itself of all perceived liabilities, even those it might otherwise be inclined to keep."[14]

Therefore, the intent behind Section 1114 was to provide additional protections to retiree benefit holders at a time when debtors are heavily encouraged to terminate benefits.[15]

While noting that its conclusion was in "tension" with other courts' holdings, including Judge Drain's decision, the Third Circuit noted that "these 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."[16]

The Third Circuit rejected all arguments that Section 1114 was ambiguous and declared that (1) it was impossible to read Section 1114 as excluding benefits that are terminable under nonbankruptcy law because "retiree benefits" are plainly defined as "payments to any entity or person ... under any plan, fund or program," and (2) Section 1114(e) could not be any clearer as it plainly states that the debtor or trustee "shall timely pay and shall not modify any retiree benefits" except as provided in Section 1114.[17]

Congress did not restrict the application of Section 1114 to only those benefits that a debtor was otherwise compelled to provide, and according to the court, if Congress wanted to exclude certain benefits from the "protective umbrella" it would have — as evidenced by Section 1114(m), which specifically excludes certain high-income retirees able to obtain comparable benefits, from the protections of Section 1114.[18]

In a similar analysis, the court also looked to Section 1114(l), which prevents an insolvent debtor from terminating retiree benefits during the six-month period prior to the bankruptcy filing.[19]

Similar to Section 1114(e), this section does not limit the meaning of "retiree benefits," and the court noted that Section 1114(l) would be meaningless if it did not apply to benefits that a soon-to-be debtor could terminate at-will.[20]

Therefore, according to the court, it is irrelevant that the debtor could have unilaterally stopped the benefit payments outside of bankruptcy, because once the bankruptcy petition is filed, under the plain language of Section 1114, a trustee must timely pay and cannot modify any retiree benefits except by following the requirements of Section 1114.

Visteon vs. Delphi

The holdings in Visteon and Delphi place significantly different burdens on a debtor seeking to modify or terminate retiree benefits. Under the Delphi standard, the debtor must first show that it has the unilateral right to modify or terminate a retiree benefit plan and that the benefits are not vested.

But under the Visteon standard, even if the debtor had a right to unilaterally terminate a benefit plan outside of bankruptcy and the benefits were unvested, it would have to follow the procedure set forth in Section 1114, including negotiating with the authorized representative of the benefit plans.

If such negotiations failed, the debtor would then have to show that the proposal was refused without "good cause" and that the requested modification was necessary for reorganization and fair and equitable, in order to modify the benefits.

Therefore, when a case is filed in the Third Circuit, retiree benefit holders have the opportunity to form a committee and negotiate. This is very different than other jurisdictions, where their voice may not be heard if the debtor has met its initial burden of proving it has the unilateral right to terminate a retiree benefit plan.

Implications and Limitations of Visteon

The Visteon holding raises the question: Did the Third Circuit contradict one of the general premises of bankruptcy law — that a constituent's prepetition contractual rights should not be improved by the mere filing of a bankruptcy case?

The Third Circuit anticipated this critique by noting that it is not the judiciary's concern whether during bankruptcy, retiree benefits should be provided greater protections than they had under state law. Rather, "that is a job for Congress."[21]

The paradox comes from the limitations in Section 1114. As recognized by the Third Circuit, the protections afforded by Section 1114 terminate upon confirmation of the plan of reorganization. Therefore, once a debtor emerges as a reorganized company, if it initially reserved the right to terminate retiree benefits, then it will have no on-going obligation to provide retiree benefits unless it voluntarily obliged itself during the bankruptcy.

Thus, a debtor must assess whether it should emerge from Chapter 11 with retiree benefits undisturbed, only to preserve the right to modify them after confirmation. After confirmation, a debtor would then look to its underlying contractual rights and, where applicable, modify or terminate retiree benefits.

As such, during bankruptcy, the "microphone" provided by Section 1114 prevents the voices of the retired benefit holders from being muffled by the more powerful creditors "carving up the pie of the bankruptcy estate"; this "microphone" might be destructible if the debtor chooses not to attempt to modify or terminate retiree benefits during the bankruptcy, with the carve-up occurring post-bankruptcy.[22]

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[1] IUE –CWA v. Visteon Corporation, et al (In re Visteon Corporation, et al), No. 10-1944, slip op. at 5 (3d Cir. July 13, 2010).

[2] See In re Delphi, No. 05-44481, slip op at 15 (Bankr. S.D.N.Y. March 10, 2009). Judge Drain's decision was appealed by both the Delphi Salaried Retirees Association and other non-union salaried retirees of Delphi Corporation and the Committee of Eligible Salaried Retirees, but the appeals were settled pursuant to the Stipulation and [Proposed] Order Voluntarily Dismissing Related Appeals Pursuant to Federal Rule of Bankruptcy Procedure 8001(c)(2), Case Nos. 1:09-cv-02564 (DAB) and No. 1:09-cv-02605 (DAB), (May 5, 2009 S.D.N.Y).

[3] Id. at 16.

[4] IUE-CWA v. Visteon Corporation, No. 10-1944, slip op. at 4 (3d Cir. July 13, 2010).

[5] 11 U.S.C. § 1114(a).

[6] Section 1114(e) thereafter states that in Section 1114, the term "trustee" shall include a debtor in possession.

[7] 11 U.S.C. § 1114(e).

[8] See 11 U.S.C. § 1114(f)(1)(A).

[9] See 11 U.S.C. § 1114(g).

[10] IUE-CWA v. Visteon Corporation, No. 10-1944, slip op. at 26 (3d Cir. July 13, 2010).

[11] Id. at 27-28.

[12] Id. at 19.

[13] Id.

[14] Id. at 85 (citing LTV Bankruptcy: Hearing before the S. Comm. On the Judiciary, 99th Congress, 2d Sess (1986) at 14)).

[15] Id. at 87.

[16] Id. at 30.

[17] Id. at 32-33, & 35.

[18] Id. at 58; see 11 U.S.C. § 1114(m).

[19] Id. at 51-52; see 11 U.S.C. § 1114(l).

[20] Id.

[21] Id. at 94.

[22] Id. at 91.