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HBD Client Alert – July 22, 2010 – *In re Visteon Corp.*

On July 13, 2010, the United States Court of Appeals for the Third Circuit issued an opinion in *IUE-CWA v. Visteon Corp. (In re Visteon Corp.)*¹ holding that the only way a debtor may terminate or modify retiree benefits during a chapter 11 case is through the special procedures set forth in section 1114 of the Bankruptcy Code, *even where the debtor unilaterally could terminate or modify those benefits at will outside of bankruptcy.*

This holding, by the influential appellate court that decides appeals from bankruptcy courts in the District of Delaware (where many corporate debtors commence chapter 11 reorganization proceedings), departs from the conclusions reached by the majority of bankruptcy and district courts that previously considered this issue and may have a significant impact on reorganization proceedings in Delaware and throughout the Third Circuit. At the least, corporate debtors with obligations to retirees will need to consider the ramifications of the *Visteon* decision in determining when and where to seek chapter 11 relief.

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Prior to bankruptcy, Visteon – one of the world’s largest suppliers of automotive parts – had agreed to provide health and life insurance benefits to retirees from two plants that it operated in Indiana. Visteon’s agreements in this regard – while memorialized in collective bargaining agreements and summary plan descriptions disseminated to qualifying employees – contained reservations of rights that permitted it to unilaterally terminate such benefits at will, for any reason.

Visteon closed the Indiana plants in 2007 and 2008 and, in 2009, filed for bankruptcy protection in the United States Bankruptcy Court for the District of Delaware. Approximately one month after filing, Visteon moved to terminate its retiree benefit plans pursuant to section 363(b) of the Bankruptcy Code, the provision governing use or sale of property of the debtor’s estate and requiring only a showing that a proposed use or sale is a reasonable exercise of the debtor’s business judgment. Retirees objected, arguing that Visteon was prohibited from terminating retiree benefits during the chapter 11 case without complying with section 1114 of the Bankruptcy Code, which provides that “the debtor in possession . . . shall timely pay and shall not modify any retiree benefits” unless the court authorizes modifications after notice and a

¹ 2010 U.S. App. LEXIS 14307 (3d Cir. July 13, 2010).

hearing and requires that, before seeking any such modification, the debtor must engage in bargaining with an authorized representative of the retirees at issue.

The Delaware bankruptcy court granted Visteon's motion as to the Indiana plant retirees, concluding that section 1114 did not apply because Visteon had the right to terminate the retiree benefits at will under non-bankruptcy law and because a contrary conclusion would result in the retirees having greater rights in bankruptcy than they would have had Visteon not filed its chapter 11 petition. The district court affirmed and the retirees appealed to the Third Circuit.

The Third Circuit reversed. It held that the plain language of section 1114, which applies to the termination or modification of "any retiree benefits", compelled the conclusion that, once in bankruptcy, a debtor's rights with respect to retiree benefits are limited by the statutory requirements notwithstanding whatever rights the debtor might have had outside of bankruptcy to modify or terminate benefits on its own: "Section 1114 could not be any clearer. It restricts a debtor's ability to modify *any* payments to *any* entity or person under *any* plan, fund, or program in existence when the debtor files for Chapter 11 bankruptcy, and it does so notwithstanding any other provision of the bankruptcy code."

The Circuit noted the difference in statutory language between section 1114 – which applies to changes to "any retiree benefits" during the bankruptcy case – with section 1129(a)(13) of the Bankruptcy Code – which provides that a debtor's plan of reorganization must provide for the continuation of retiree benefits "for the duration of the period the debtor has obligated itself to provide such benefits." The Circuit held that the difference in language was purposeful and was intended to provide for continuation of benefits *during* the chapter 11 proceedings while enabling debtors to resort to their non-bankruptcy rights to terminate or modify benefits *after* the bankruptcy case has concluded (through confirmation of a plan of reorganization).

The Circuit found additional support for its reading of section 1114 in the 2005 addition to the Bankruptcy Code of section 1114(l), which provides for the bankruptcy court to reinstate any retiree benefits terminated or modified by the debtor within 180 days before the bankruptcy petition date and while the debtor was insolvent. According to the Circuit, section 1114(l) would be "virtually meaningless" if held not to apply to retiree benefits that a debtor could modify or eliminate unilaterally and therefore supports the proposition that section 1114 was intended to expand the rights of retirees beyond those afforded them by applicable non-bankruptcy law.

On this latter point, the Circuit recognized the venerable principle that property rights and entitlements in bankruptcy generally are defined and governed by non-bankruptcy law. *See Butner v. United States*, 440 U.S. 48 (1979). The Circuit, however, held that Congress has the power to override that general rule where a federal interest compels a different result and that section 1114 clearly represents a congressional determination to override non-bankruptcy law with respect to retiree benefits in bankruptcy cases. Specifically, the Circuit surmised that Congress intended to protect retiree benefits during bankruptcy, a time when benefits are vulnerable to the demands of competing creditors. The Circuit observed that retiree benefits are a form of deferred compensation and that during "good times" market forces do much to restrain an employer from exercising a unilateral termination right. In contrast, during "bad times", the

debtor is under pressure to relieve itself of all liabilities, including those it might otherwise be inclined to keep. According to the Circuit, section 1114 thus affords 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.

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The *Visteon* decision is significant in several respects. First, retirees – even those whose benefits could have been terminated outside of bankruptcy – now have significant leverage and rights in bankruptcy cases pending in the Third Circuit, including those filed in Delaware. As a consequence of the Circuit’s determination that all retiree benefits must be honored during a bankruptcy case (unless the bankruptcy court orders otherwise in accordance with the strictures of section 1114), creditor constituencies in a bankruptcy case will have to account for additional stresses on the debtor’s liquidity and deal with retiree representatives at the bargaining table should those constituencies seek to modify retiree benefits in order to lessen the debtor’s ongoing cash demands. The *quid pro quo* for any such modifications may be agreement to continue some retiree benefits beyond plan confirmation, even in cases where the debtor otherwise would have the right to terminate benefits upon confirmation in accordance with section 1129(a)(13).

Second, the decision will impact the pre-bankruptcy planning of any debtor contemplating filing a bankruptcy case within the Third Circuit. Among other things, the decision may have the perverse effect of compelling prospective debtors to modify or terminate retiree benefits at the onset of financial distress, with the objective of eliminating benefit payments at least 180 days before any future bankruptcy filing and thereby avoiding *Visteon*’s mandate of ongoing retiree benefit payments throughout the prospective bankruptcy case. At the least, limitations on retiree benefits likely will be among the first issues considered by a distressed company and its counsel.

Third, the Third Circuit now finds itself at odds with the lower courts in a number of other jurisdictions, including the influential Southern District of New York. For prospective debtors with substantial obligations in respect of retiree benefits, especially those unable to terminate or modify retiree benefits more than six months before filing a chapter 11 case, *Visteon* may result in more bankruptcy cases being filed outside of the Third Circuit (for those debtors with other venue options).

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If you have any questions about this decision and its potential effects, please contact Bruce Bennett, Jim Johnston, Jason Wolf, or other members of our business reorganization and bankruptcy group.

