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Editor's Overview

Our focus this month is on the Third Circuit's decision in *In re Visteon*, which held that Section 1114 of the Bankruptcy Code applies to all retiree benefits — vested and unvested — and, as a result, a plan must continue to pay unvested retiree benefits during the pendency of bankruptcy unless the bankruptcy court approves otherwise. The Third Circuit's decision departs from the rulings of other federal courts and appears to be in conflict with a decision from the Second Circuit. As the authors discuss below, the Third Circuit's ruling could cause employers to eliminate their retiree benefit plans for fear that they will not be able to do so in bankruptcy.

As always, be sure to review the section on *Rulings, Filings and Settlements of Interest*.

Third Circuit Concludes that Employees' *Unvested* Retiree Benefits Are Protected During an Employer's Chapter 11 Bankruptcy[1]

By Anthony S. Cacace and Russell L. Hirschhorn

In *In re Visteon Corp.*, No. 10-1944-cv, 2010 WL 2735715 (3d Cir. July 13, 2010), the Third Circuit held that Visteon Corporation (Visteon) could not terminate unvested retiree health and life insurance benefits during a Chapter 11 bankruptcy without seeking court approval pursuant to Bankruptcy Code § 1114, 11 U.S.C. § 1114. The Third Circuit's decision departs from the rulings of many other federal courts, and is in tension, if not outright conflict, with the Second Circuit's decision in *LTV Steel Co. v. United Mine Workers (In re Chateaugay Corp.)*, 945 F.2d 1205 (2d Cir. 1991), which held that a bankruptcy trustee had no obligation to continue paying benefits pursuant to a collective bargaining agreement that had expired during the pendency of the bankruptcy. If the Third Circuit's view becomes the prevailing view, or if a conflict among the Circuit Courts surfaces, employers may be deterred from sponsoring retiree welfare arrangements.

Background and Procedural History

In 2007, Visteon, a former division of Ford Motor Corporation, began downsizing its operations and closing several of its plants due to economic struggles. On May 28, 2009 Visteon filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the District of Delaware. During the bankruptcy proceeding, Visteon requested permission from the bankruptcy court to terminate all retiree health and life insurance benefit plans without complying with the provisions set forth in Bankruptcy Code § 1114.

Section 1114 provides certain procedural and substantive protections for retiree benefits during a Chapter 11 proceeding. It was enacted as a part of the Retiree Benefits Bankruptcy Protection Act of 1988 (RBBPA) and was passed in response to LTV Corporation's termination of retiree benefits of approximately 78,000 retirees without any advance notice while in bankruptcy. Section 1114 defines "retiree benefits" to include payments "to any entity or person . . . 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 petition commencing a case under this title." Pursuant to procedures set forth in Section 1114(e)-(f), the bankruptcy "trustee shall timely pay and shall not modify *any* retiree benefits" unless the court approves a modification pursuant to either an agreement to modify reached by the trustee and the retirees, or a motion initiated by the trustee or authorized representative of the retirees. Before making any such motion the trustee must attempt to reach an agreement with the retirees. Courts will grant a motion to modify retiree benefits under Section 1114 only if the trustee makes a proposal satisfying the statute's requirements, the retirees' representative refuses the proposal without "good cause," the modification is necessary to the reorganization of the debtor, and it results in "all creditors, the debtor, and all affected parties [being] treated fairly and equitably.

In its application, Visteon contended that it need not comply with Section 1114 because the employees were not vested in their retiree and life insurance benefits. According to Visteon, the benefits were not vested because Visteon had reserved the unilateral right to terminate all retiree health and life insurance benefit plans in the plan documents. The Industrial Division of the Communications Workers of America (Union), which represented about 2,100 employees affected by Visteon's proposed termination of retiree and life insurance benefits, opposed Visteon's motion on the grounds that Visteon could not terminate the benefits while in Chapter 11 without complying with the provisions set forth in Bankruptcy Code § 1114.

The bankruptcy court agreed with Visteon that Section 1114 was not implicated where, as here, the retirees did not have any vested rights to the benefits. In so ruling, the bankruptcy court reasoned that restricting Visteon's right to terminate the retiree benefits "would lead to an absurd result in that it would expand retiree rights beyond the scope of state law for no legitimate bankruptcy purpose." The federal district court denied the Union's appeal, finding that the bankruptcy court's findings were not clearly erroneous.

The Third Circuit's Decision

The Third Circuit's holding on appeal was short and to the point: Section 1114 "is unambiguous and clearly applies to any and all retiree benefits." It mattered not, according to the Third Circuit, that employees were not vested in these benefits, since Section 1114 plainly applied to "all" retiree benefits.

In so holding, the Third Circuit rejected all of Visteon's arguments to the contrary. *First*, the Court rejected Visteon's argument that the legislative intent behind Section 1114 was to protect the expectations of the parties involved in the bankruptcy and thus protected only those retiree benefits that the debtor was obligated to pay to retirees. The Court determined that it should not deviate from the plain language of Section 1114 to examine its legislative intent because there had not been an "extraordinary showing" of contrary legislative intent. The Court stated that Visteon's reference to the comments of "certain legislators' statements that § 1114 would prevent debtors from reneging on their 'promises' or their 'legal and contractual obligations'" fell "woefully short" of an extraordinary showing of contrary intent. The Court commented that it was not surprising that the legislative history reflected concerns about a debtor's legal obligations and the expectations of the parties, but this did not mean that the safeguards set forth in Section 1114 "are triggered *only* in those instances where the debtor is legally or contractually obligated to provide benefits."

Second, the Third Circuit dismissed several arguments advanced by Visteon in support of the conclusion that the language of Section 1114 was ambiguous. According to the Court, it was "impossible to read the plain language of § 1114 as excluding benefits which are terminable outside of bankruptcy because . . . they are plainly 'payments to any entity or person . . . under any plan, fund, or program.'"

The Court also was unpersuaded with the argument that the Second Circuit's decision in *In re Chateaugay Corp.*, 945 F.2d 1205 proved that the statute was ambiguous. In *In re Chateaugay*, the Second Circuit ruled that a debtor was not required to continue paying retiree benefits during its bankruptcy because the CBA that required the payments expired during the bankruptcy, and thus, no further payments were required pursuant to the "plan, fund or program" under which the benefits were initially provided. The Third Circuit concluded that the *Chateaugay* court had failed to remain faithful to the plain language of Section 1114 when it determined that the statute only "mandated continuation of payments the debtor was *required to make under a plan*." It also held that the *Chateaugay* court mistakenly focused on the debtor's contractual obligations as if a bankruptcy had not occurred, instead of focusing on what payments were being made under the planat the time the company filed a petition for bankruptcy. According to the Third Circuit, Section 1114 contemplates preserving the benefits being provided at the time the bankruptcy petition is filed and it does not allow for modification of those benefits simply because the debtor's obligation changes during the pendency of the bankruptcy.

Visteon also argued without success that Section 1114 is ambiguous when read in conjunction with Section 1129(a) (13) of the Bankruptcy Code, which provides that in order to emerge from a Chapter 11 bankruptcy, the debtor's reorganization plan must provide for the continuation of retiree benefits "for the duration of the period the debtor has obligated itself to provide such benefits." Visteon contended that Section 1114 should be construed to apply similarly to only those retiree benefits to which the debtor was obligated to provide benefits. The Third Circuit rejected this argument and observed that Section 1114 contains no such limitation.

The Court also was persuaded by the text of subsection (*l*) to Section 1114, which was added in 2005, after several of the decisions on which Visteon purported to rely. Subsection (*l*) prevents an insolvent debtor from terminating retiree benefits in the six-month period before filing for bankruptcy. The Court observed that this subsection, which similarly contains no limitation based on whether the employer obligated itself to continue providing these benefits, would have no purpose if it was limited to benefits that a plan sponsor was prohibited from terminating by virtue of vesting rules in ERISA and the Labor-Management Relations Act. The Court acknowledged the court in *In re Delphi Corp.*, 2009 WL 637315 (Bankr. S.D.N.Y. Mar. 10, 2009), had considered and rejected the relevance of subsection (*l*), but concluded that the *Delphi* decision was "unpersuasive" because its analysis was "not faithful to the plain language rule that it purport[ed] to, and must, apply."

Finally, the Third Circuit determined that interpreting Section 1114 to give retirees more rights under Chapter 11 than they would have outside of bankruptcy was not so "absurd" as to justify disregarding the plain language of the Bankruptcy Code. The Court reasoned that although "some courts have been unable to understand why Congress would protect certain retiree benefits during bankruptcy, but not otherwise, the short answer may be that the RBBPA, like many legislative enactments, was an imperfect compromise." The Court further opined that "there is compelling logic to protecting these benefits solely during bankruptcy-when benefits are highly vulnerable, and limited protections can have a significant impact."

Following the Third Circuit's decision, the bankruptcy court ordered Visteon to retroactively pay benefits to retirees that the company had cut off.

Proskauer's Perspective

It is important to remember that ERISA was passed not only to protect employees' rights to their benefits, but to do so in a way that would not discourage plan sponsors from establishing employee benefit plans in the first place. This is particularly true in the context of employee welfare plans since Congress did not require employees to be afforded accrual and vesting rights to these benefits as they are in employee pension and retirement plans. By compromising the right to terminate benefits in the context of bankruptcy filings, the Third Circuit's ruling potentially undermines that Congressional goal.

The Third Circuit's ruling thus could cause employers to take another look at their retiree benefit plans and consider eliminating them now (provided that they have reserved the right to do so in the applicable plan documents) in order to avoid the possibility of not being able to do so in the event bankruptcy becomes necessary.

Rulings, Filings and Settlements of Interest

- In *In re Mercury Interactive Corp. Sec. Litig*., 2010 WL 3239460 (9th Cir. Aug. 18, 2010), the Ninth Circuit held that in the settlement of a putative class action district courts must set the deadline for class counsel to file their fee application before the deadline for class members to object to the proposed settlement. Because the district court had not done so in this securities action, the Court vacated the district court's ruling approving plaintiffs' fee application. The ruling, if adopted elsewhere, should similarly impact ERISA class actions.
- Following the U.S. Supreme Court's denial of *certiorari* in *Golden Gate Restaurant Assoc. v. City and County of San Francisco*, litigation surrounding San Francisco's "pay or play" statute was brought to an end when the district court granted the city's motion for summary judgment in a one paragraph order. The Ninth Circuit's opinion, which held that the San Francisco ordinance was not preempted by ERISA is discussed at http://www.proskauer.com/publications/newsletters/erisa-litigation-newsletter-november2008/.
- In *Zang v. Paychex, Inc*., 2010 WL 3021909 (W.D.N.Y. Aug. 2, 2010), the court dismissed plaintiff's allegations that Paychex breached its fiduciary duties by collecting revenue-sharing payments from mutual funds that Paychex selected to be included in its prototype plans that are sold to various employers. Relying on *Hecker v. Deere*, the court concluded that "playing a role in the selection of investment options or furnishing professional advice is not enough to transform a company into a fiduciary . . . . Even if Paychex could be said to have 'played a role' in plaintiff's decision (by presenting him with a set of options), in the end, that decision was plaintiff's to make."
- In *American Federation* of *Television & Radio Artists v. JP Morgan Chase Bank NA*, 2010 WL 3063067 (S.D.N.Y. Aug. 5, 2010), a district court certified a class in three consolidated suits alleging that JP Morgan Chase ("JPMC") breached its fiduciary duties by mismanaging billions of dollars of retirements plans' assets. The certified class consists of all plans that had securities lending agreements with JPMC and on whose behalf JPMC held notes from Sigma as of September 30, 2008. The suits maintain that, pursuant to the securities lending arrangements, JPMC purchased and held notes from Sigma Finance Inc. even after financial analysts warned of Sigma's severe lack of liquidity, which led to the notes' decline in value.

- In *Taylor v. KeyCorp*, No.08 Civ. 1927 (N.D. Ohio Aug. 12, 2010), the court granted KeyCorp's motion to dismiss plaintiff's claims that defendants breached their fiduciary duties by continuing to invest in KeyCorp stock while the stock was allegedly artificially inflated. In so ruling, the court held that plaintiff lacked standing to assert such claims because plaintiff profited on her investment in KeyCorp stock during the putative class period and thus did not suffer a cognizable injury. In so ruling, the court rejected plaintiff's contention that the court should employ an "alternative investment" damages model "which measures losses to a plan from breaches of the duty of prudence by comparing the performance of the imprudent investments with the performance of a prudently invested portfolio." The court concluded that because the "gravamen" of plaintiff's claim was that KeyCorp stock was artificially inflated, the proper measure of damages is "'out-of-pocket' damages, i.e., the difference between what the plaintiff paid for the stock and what it was really worth." Because plaintiff not only bought, but also sold, his/her shares at inflated prices, the court determined that there were no "out of pocket" losses.
- In *In re Constellation Energy Group Inc. ERISA Litig.,* No. 08 Civ. 2662 (D. Md. Aug. 13, 2010), the district court granted Constellation Energy Group, Inc.'s motion to dismiss plaintiffs' claims that defendants breached their fiduciary duties by failing to divest the plans of Constellation stock after Constellation's stock price declined by 74% during the putative class period. The court determined that it need not consider whether the plan fiduciaries had the discretion to divest the plans of the company stock fund, or whether the *Moench* presumption of prudence applied, because plaintiffs failed to allege that "the defendants acted imprudently by retaining employees' investments in Constellation stock during the Class Period." The court stated that "[a] company's decision to adopt a riskier business model is not in itself a fiduciary decision governed by ERISA, nor does that decision automatically trigger a duty to divest." The court also concluded that plaintiffs failed to allege sufficient facts to support a finding that the defendants' communications to plan participants contained material misrepresentations.
- On August 9, 2010, the court in *Will v. Gen. Dynamics Corp*., No. 06-698 (S.D. Ill.) granted preliminary approval of a $15.5 million settlement of plaintiffs' claims that defendants breached their fiduciary duties under ERISA by paying excessive and unreasonable fees for the plans' 401(k) investments.
- On August 12, 2010, the court in *Martin v. Caterpillar, Inc*., No. (C.D. Ill.) granted final approval of a $16.5 million settlement of plaintiffs' claims that defendants breached their fiduciary duties under ERISA by paying excessive and unreasonable fees for the plans' 401(k) investments.

- In *Hochstadt v. Boston Scientific Corp.*, No.08 Civ. 12139 (D. Mass. Aug. 11, 2010), the court approved a settlement of plaintiffs' stock-drop claims. The settlement requires the company to pay $8.2 million for distribution to approximately 12,000 participants in the company's 401(k) plan. Plaintiffs' counsel was awarded approximately $2.7 million in fees.
- In *In re Washington Mutual Inc. ERISA Litig.*, No.08 md 01919 (W.D. Wash. Aug. 6, 2010), the court granted preliminary approval of plaintiffs' stock-drop claims. The settlement requires the company to pay $49 million to all participants whose plan accounts held investments in WaMu stock from October 15, 2005 to September 26, 2008.
- In *Beazer Homes USA Inc. ERISA Litig.*, No.07 Civ. 0952 (N.D. Ga. Aug. 12, 2010), the court granted preliminary approval to a settlement of plaintiffs' stock-drop claims against Beazer Homes USA. The settlement requires the company to pay $5.5 million to all participants and beneficiaries who were invested in the Beazer stock fund from July 28, 2005 to May 12, 2008.
- In *In re Ford Motor Co. ERISA Litig.*, No.06 Civ. 11718 (E.D. Mich. Aug. 2, 2010), the parties reached an agreement to settle plaintiffs' stock-drop claims. The settlement does not call for any monetary relief to the plaintiffs, but does require Ford to: (i) provide participants with online investment advice tools; (ii) hire a third party to conduct fiduciary training once a year for the people overseeing plan investments for the following four years; (iii) provide information to participants regarding the diversification of their accounts; (iv) notify participants if their holdings in Ford stock exceed 20 percent of their total plan holdings; (v) make any employer contributions over the next three years in cash; and (vi) make available to the trustees of the plan, upon request, all current and historical information about the company and the plans.

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