

INTERSECTION OF ERISA'S BENEFIT LAW AND THE U.S. BANKRUPTCY CODE

Your company is on the ropes. You are looking to cut costs wherever possible so you can reorganize in bankruptcy. Your ERISA plan gives the company the right to terminate benefits unilaterally, so you think you can save money by cutting those benefits. After all, if the company was not in bankruptcy court you could simply terminate them. However, a federal appeals court recently held that § 1114 of the Bankruptcy Code potentially prevents you from doing so – even though your plan may expressly allow you to terminate the benefits unilaterally.

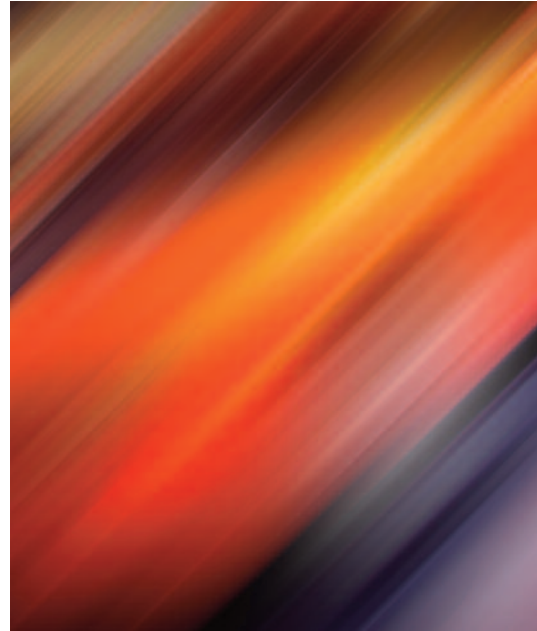
BACK TO THE FUTURE

Added to the Bankruptcy Code back in the mid-1980s, § 1114 provides protections for retiree benefits during a Chapter 11 reorganization bankruptcy proceeding.¹ It states that the bankruptcy trustee must try to reach an agreement with the retirees regarding their promised benefits prior to asking the bankruptcy court to modify or terminate such benefits. As part of this process the trustee must provide the retirees with information about the company's financial situation to allow for an informed evaluation of the proposal.

Prior to the recent Court of Appeals decision (Third Circuit) in *In re Visteon Corp.*,² however, lower courts had been allowing companies to terminate these benefits by essentially holding that compliance with § 1114 would present the “absurd” result of providing retirees **more** benefits in bankruptcy court than they would have had pre-bankruptcy. According to the most recent decision, the lower courts got it wrong.

RECENT CASE REVIEW: IN RE VISTEON CORP

The *Visteon* court's expansive reading of the Bankruptcy Code – expanding the retirees' prepetition rights during bankruptcy – may make it the most significant appeal court decision to date on the topic of retiree benefits in bankruptcy. The court reads § 1114 as applying to retiree benefits, even where the debtor could terminate those benefits outside the scope of a bankruptcy proceeding:



“Notwithstanding any other provision of this title, the [trustee] shall timely pay and shall not modify any retiree benefits,” except by following the procedures provided by the statute.³

The Third Circuit court of appeals held that a plain reading of the statute is *not* to prevent the debtor company from ever terminating retiree benefits, but rather to lay out a procedure and standards for the process. Instead of unilaterally terminating benefits, the debtor will have to present the proposal to terminate benefits based on an economic necessity to do so. The retirees can then counter with their own reasons why such action is not equitable. If the retirees do not accept the company's proposal, the company can ask the court to reduce benefits without the retirees' consent. The court will then grant such relief if it finds that the cut is economically necessary, the retirees have refused to accept it without showing “good cause,” and the “modification is necessary to permit reorganization of the debtor and ensures that all creditors, the debtor and all of the affected parties are treated fairly and equitably.”⁴

WHAT DOES THIS MEAN FOR YOU?

While it is unclear if other appellate courts will adopt the Third Circuit's holding, you should be aware that this ruling may make it more difficult to eliminate retiree benefits in the bankruptcy setting, no matter what you explicitly provide for in your ERISA plan. Courts may choose to affirm a company's attempt to terminate these benefits, but you should be prepared for a possible time consuming and costly process. If the ruling is followed, it not only gives your retirees more of a voice in the decision to cut benefits, but it also gives them priority they would not otherwise have. Any payment for retiree benefits required during a Chapter 11 proceeding will be considered an "allowed administrative expense" rather than the retirees merely being unsecured creditors.

Although the possible effects of this decision relative to your Fiduciary Liability insurance are not clear at this time, it seems likely that the coverage might well be implicated. If the claimants don't make clear allegations of breach of fiduciary duty under ERISA, then their focus might be on an alleged error or omission in plan administration, either of which might serve to trigger Fiduciary Liability coverage if only for defense costs. As courts continue contending with this issue, we are likely to see more litigation. At this time our best recommendation is to be prepared for change and read your Fiduciary Liability policy carefully.

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¹ Section 1114 was enacted after the bankruptcy of steelmaker LTV Steel Corporation.

² No. 10-1944, 2010 WL 2735715 (3d Cir. July 13, 2010).

³ Bankruptcy Code § 1114.

⁴ The court noted that its decision would not create a situation where distressed companies would jettison their benefits plans at will on the eve of bankruptcy to avoid dealing with its reading of §1114's procedures – due to the provision inserted in 2005 which requires debtors to retroactively reinstate retiree benefits that were modified within 180 days prepetition. The appeals court viewed this as supportive of a Congressional intent to heighten protections for retirees during bankruptcy and limit companies' ability to shed benefits while in distress.