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Legislative Update – Senate Bill 2418

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Senate Bill 2418, titled the "Bankruptcy Fairness and Employee Benefits Protection Act of 2014," was introduced on June 3, 2014, by Senator John Rockefeller and co-sponsored by Senator Elizabeth Warren. The bill was immediately referred to the Committee on the Judiciary. No further action has since been taken.

The bill makes various changes to the provisions of the Bankruptcy Code that address (a) the treatment of collective bargaining agreements and retiree benefits under, respectively, sections 1113 and 1114, (b) the priority of pre-petition unsecured claims for employee compensation and contributions to employee benefit plans under section 507, (c) compensation paid or payable to insiders of the debtor under sections 503 and 547, and (d) the sections of the Bankruptcy Code that are made applicable to municipal bankruptcy cases under section 901 of chapter 9. In addition, the proposed legislation would add a new section 1117 to the Bankruptcy Code dealing with a debtor's obligation to make minimum funding contributions to pension plans. Last, the bill would make changes to sections 1408 and 1412 of the Judiciary and Judicial Procedure code (title 28) addressing the venue (and change of venue) of bankruptcy cases.

Last, the bill also makes various amendments to ERISA (codified in title 29) to require employers to notify employees about vesting rights for health care benefits and whether the terms of the employment contract permit the employer to unilaterally modify or terminate the benefits in the future. The bill would also prohibit corporations and unions from entering into collective bargaining agreements that reduce or terminate retiree health care benefits for individuals who have already retired under the terms of a previous contract. These proposed changes to ERISA are not discussed in this legislative update.

Collective Bargaining Agreements -- Section 1113

Section 1113 of the Bankruptcy Code sets forth the heightened standards and procedural requirements for a chapter 11 debtor to reject a collective bargaining agreement (CBA). Unlike the generally accepted "business judgment" standard applicable to the rejection of an executory contract or unexpired lease, section 1113 imposes a more stringent "balance of the equities" standard for the Bankruptcy Court to authorize the debtor to reject a CBA (following the completion of a detailed process that requires a proposal for consensual modifications, the disclosure of relevant information and good faith negotiations). The bill would amend section 1113 to limit the ability of a debtor to seek to consensually modify a CBA as a condition to rejection (if the employee representatives do not assent to the modifications). Currently, the statute provides that a debtor may seek any pre-rejection modifications "necessary to permit the reorganization of the debtor." The proposed legislation would flip this standard to allow only those minimum modifications "necessary to prevent the liquidation of the debtor."

In addition, if the debtor proposes, as part of its requested modifications, to also modify any health insurance benefits of any employees covered under a CBA, it must also make modifications to the health insurance benefits of its officers and directors that (i) are comparable to the rank and file modifications, and (ii) render the benefits to officer and directors "not more generous than those of employees." Similar requirements would apply to any proposed modifications to benefits *other than* health insurance benefits (such as wages and pension benefits) of covered employees (*i.e.*, the debtor must also make proportionate changes to the wages and pension benefits of its officers and directors).

If the debtor's proposal to modify the CBA (and make corresponding changes to the benefits of officers and directors as required), fails to lead to a consensually modified CBA and the debtor therefore seeks court approval to reject the CBA, the Bankruptcy Court may only approve the rejection if the debtor establishes by "clear and convincing evidence" that its pre-rejection proposal was the "minimum modification necessary to prevent liquidation."

Last, the bill clarifies that the rejection of a CBA under section 1113 constitutes a breach of the agreement entitling the covered employees to assert a claim for damages (similar to existing provisions under sections 365(g) and 502(j) of the Bankruptcy Code applicable to a claim for damages arising as a result of the deemed breach under a rejected executory contract or unexpired lease).

Retiree Benefits -- Sections 1114 & 1129(a)(13)

Section 1114 of the Bankruptcy Code adopts similar procedural steps that apply to the rejection of CBAs to the modification by a chapter 11 debtor of retiree benefits (defined under the statute to mean payments to retired employees for, among other benefits, medical, surgical or hospital care). Specifically, under current law, before seeking an order permitting any modifications to existing retiree benefits, the debtor must make a proposal for changes "necessary to permit the reorganization of the debtor." As with the revisions to section 1113 discussed above, the bill would provide that a debtor's proposal to modify retiree benefits could seek only those minimum

modifications "necessary to prevent the liquidation of the debtor." Moreover, any proposal to modify retiree benefits must be accompanied by corresponding changes to the health insurance benefits of officers and directors of the debtor.

If, following the proposal and negotiation period, the Bankruptcy Court permits modifications to retiree benefits under section 1114, the proposed legislation would add new provisions granting a general unsecured claim to an affected retired employee "equal to the value of the retiree benefits lost as a result of the modification." That claim, in turn, would be reduced by additional cash payments required to be made by the debtor to retirees on the effective date of a plan (pursuant to proposed amendments to section 1129(a)(13), governing the requirements to confirm a plan).

These new cash payments would be equal to (a) the cost of COBRA premiums (*i.e.*, continuation coverage) for 2 years, or (b) the cost of health insurance premiums for 2 years under a comparable plan offered under the insurance policy exchanges created by Patient Protection and Affordable Care Act. These cash payments that would be required under a plan (but only if the Court permits modifications to retiree benefits following the procedures under section 1114) could be increased to compensate for coverage for more than 2 years "if the court determines it to be in the interest of fairness and equity." But, the cash payments required under the plan for future health insurance coverage to an affected retiree cannot exceed the total amount of the retiree's unsecured claim for lost benefits.

Priority Employee Claims – Section 507

The bill would increase to $25,000 the ceiling for priority claims for wages and benefit plan contributions under, respectively, sections 507(a)(4) and (5) of the Bankruptcy Code, and would further extend the period such amounts could be earned from 180 days to 1 year.

Insider Compensation – Sections 503 and 547

Section 503(c) of the Bankruptcy Code would be amended to flatly prohibit "a bonus payment to an insider of the debtor, including an incentive-based bonus payment." This restriction would be added to existing limitations on retention plans and severance payments to insiders. Moreover, Section 547 (avoidable preferences) would be amended to "prohibit" (not avoid or recover) a transfer of compensation made to an insider made within 1 year before the petition date if the court finds that the transfer was not made in the ordinary course of business or "resulted in unjust enrichment." An adversary proceeding would not be required to seek such relief; rather, the bill permits the Bankruptcy Court to prohibit the compensation upon the motion of a party in interest.

Scope of Chapter 9 – Section 901

Currently, under chapter 9 of the Bankruptcy Code, there are no priorities conferred upon pre-petition claims. The bill would amend section 901, which lists the sections of title 11 that are made applicable to cases under chapter 9, to include sections 507(a)(4) and (5) of the Bankruptcy Code (establishing priority status for certain claims for employee wages and for contributions to employee benefit plans). In addition, under current law, the rejection by a municipal debtor of a collective bargaining agreement is not subject to the stringent requirements of section 1113 but

rather to the special scrutiny under the Supreme Court's decision in *Bildisco*. This bill would also incorporate sections 1113 and 1114 into chapter 9 and would further incorporate section 1129(a)(13) (as amended in the fashion described above) to also require a municipal plan of adjustment to provide for the continuation of retiree benefits for the period the municipality had obligated itself to make such payments, as well as to require additional cash payments upon confirmation for continued health insurance coverage to retired public employees (as discussed above in the context of chapter 11 cases).

ERISA Pension Plan Contributions – New Section 1117

The bill would add a new section 1117 to the Bankruptcy Code intended to require a debtor that either sponsors a pension plan (under ERISA), or that is a member of a sponsor's controlled group, to continue making minimum funding contributions to the pension plan as and when due under applicable law. The legislation would also treat any missed pension contributions "due to be made after the petition" as an administrative expense under a new section 503(b)(10). Moreover, the bill would amend section 362 of the Bankruptcy Code to allow the Pension Benefit Guaranty Corporation to perfect, maintain or continue a statutory lien imposed for the failure to make required pension contributions. Significantly, in a departure from existing law, this new exception to the automatic stay would apply "without regard" to whether the missed "contributions became due or whether such lien arose before or after the filing of the petition."

Venue – Sections 1408 and 1412 of Title 28

The bill also makes two changes to the provisions for the venue of bankruptcy cases. First, section 1408 would be revised to require a debtor to file for bankruptcy in the district where the largest share of its employees, retirees, physical assets and operations are located. The ability to venue a case in the jurisdiction where an affiliate's case is pending would be eliminated. Second, section 1412 would be revised to permit a Bankruptcy Court to transfer the venue of a case (using the existing interest of justice or convenience of the parties standards), but only to the district where the person or entity's principal place of business for the preceding year was located (as opposed to any other district under existing law).