

Global Aviation Holdings: The KERP Is Back

Law360, New York (August 06, 2012, 1:11 PM ET) -- In a recent decision^[1] involving Global Aviation Holdings Inc. and its affiliated debtors (collectively, the “debtors”), the United States Bankruptcy Court for the Eastern District of New York granted the debtors' motion for approval of a key employee retention plan (the “KERP motion”) pursuant to Sections 363(b) and 503(c)(3) of Title 11 of the United States Code over the objections of both the United States Trustee for Region 2 (the “UST”) and the official committee of unsecured creditors (the “committee”).

In the objections, the committee and the UST argued the debtors were seeking to pay bonuses to insiders without satisfying the requirements set forth in Section 503(c)(1) of the Bankruptcy Code. The committee and the UST also argued, that to the extent the key employee retention plan recipients turned out to be non-insiders, the debtors did not establish whether the proposed key employee retention plan payments were “justified by the facts and circumstances of the case” as required by Section 503(c)(3) of the Bankruptcy Code.

The debtors operate two airlines: North American Airlines Inc. and World Airways Inc. From the outset of their bankruptcy cases, the debtors planned to move North American’s headquarters from JFK International Airport in Jamaica, N.Y., to World’s headquarters in Peachtree City, Ga., in order to consolidate operations.

The debtors filed the KERP motion to pay bonuses to five employees of North American: the director of safety; the vice president of operations; the chief pilot; the senior director of maintenance; and the chief inspector (the “KERP employees”). The debtors structured the proposed KERP payments as a percentage of each KERP employee’s base salary in accordance with the debtors’ prepetition annual bonus plan. The debtors intended the proposed payouts to ensure each of the KERP employees remains with the debtors during the relocation of North American’s operations to Georgia. The debtors also stated payments would be made under the KERP once the Federal Aviation Administration approved of North American’s operations transfer to Georgia.

The committee objected to the debtors’ characterization of the KERP employees as “non-insiders.” The committee asserted that the KERP employees have oversight authority over areas of North American’s corporate policy consistent with the status of insiders. Therefore, the KERP should be reviewed under Section 503(c)(1) of the Bankruptcy Code, which requires a higher evidentiary showing than those made by the debtors. Also, the committee argued that even if the KERP employees are determined not to be insiders, the debtors have not met the standard for permissible bonus payments “outside the ordinary course of business” as set forth in Section 503(c)(3) of the Bankruptcy Code.

Similarly, the UST objected to the KERP motion arguing that the debtors failed to provide sufficient evidence to establish that one of the KERP employees — the director of safety — is not an insider of the debtors. The UST further argued that, whether or not the director of safety is an insider of the debtors, the debtors have not demonstrated that the proposed bonuses to be paid to the KERP employees were reasonable from a “business judgment” perspective.

In overruling the objections, the court found sufficient evidence in the record to establish that the KERP employees were not “insiders” of the debtors (as defined in Section 101(31)(B) of the Bankruptcy Code). Specifically, none of the KERP employees serves as a member of the debtors’ board of directors, participates in corporate governance activities, qualifies as officers, received their positions by appointment from the debtors’ board of directors, are paid at the debtors’ highest pay grade, receive equity in the debtors’ companies as part of their compensation package, appear in the organizational structure at the most senior management level, or have discretionary control over substantial budgetary amounts.

Rather, while the KERP employees play an important role in the debtors’ communications with the FAA, their responsibility for the “day-to-day operations” of the debtors’ businesses are consistent with the status of mid-ranking, non-insider employees. With this determination, the court found Section 503(c)(1) of the Bankruptcy Code was inapplicable to its review of the KERP motion.

The Court next looked to Section 503(c)(3) of the Bankruptcy Code, which governs bonus payments made to employees who are outside of the ordinary course of business. Here the court found that the debtors demonstrated a reasonable relationship existed between the proposed KERP and the results the debtors sought to obtain, specifically that the KERP employees will remain employees of the debtors until the FAA approves the transfer of North American’s operations to Georgia.

The court also determined (1) the KERP employees fill five positions that are specifically required by FAA regulation 119.65, and oversee and manage the systems that must be approved by the FAA as a prerequisite to the debtors’ relocation to Georgia; (2) the KERP payment amount, which in the aggregate sought to pay the KERP employees bonuses totaling \$137,031, was reasonable; (3) the scope of the KERP was appropriate in that it excluded senior executives of the debtors and proposed to pay bonuses to a specific group of mid-ranking employees holding positions mandated by the FAA and critical to the timely relocation of the debtors’ operations to Georgia; (4) the KERP is consistent with the debtors’ prepetition bonus program; and (5) the KERP was structured with the assistance of a compensation consultant.

The decision in *Global Aviation* signals that bankruptcy courts are still amenable to approving reasonable retention bonus programs that are rationally related to the success of the debtor’s business and specifically narrow in scope to achieve a particular purpose or goal.

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[1] *Global Aviation Holdings Inc., et al.* (Case. No. 12-40783 Bankr. E.D.N.Y. July 24, 2012) Docket No. 524), available at www.nyeb.uscourts.gov.

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