

To View in Browser or from a BlackBerry, click [here](#).



Forward  
Attorney Advertising

July 2012

## The KERF Is Back!

By: Sharon L. Levine, Esq.; S. Jason Teele, Esq., and Cassandra Porter, Esq.

In a recent decision<sup>1</sup> involving Global Aviation Holdings, Inc. and its affiliated debtors (collectively, the "**Debtors**"), the United States Bankruptcy Court for the Eastern District of New York (the "**Bankruptcy Court**") granted the Debtors' motion for approval of a key employee retention plan (the "**KERF Motion**") pursuant to sections 363(b) and 503(c)(3) of Title 11 of the United States Code (the "**Bankruptcy Code**") over the objections ("**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 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 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 ("**KERF**") 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. ("**North American**") and World Airways, Inc. ("**World**"). From the outset of their bankruptcy cases, the Debtors planned to move North American's headquarters from JFK International Airport in Jamaica, New York, to World's headquarters in Peachtree City, Georgia, in order to consolidate operations.

The Debtors filed the KERF 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 "**KERF Employees**"). The Debtors structured the proposed KERF payments as a percentage of each KERF Employee's base salary in accordance with the Debtors' prepetition annual bonus plan. The Debtors intended the proposed payouts to ensure each of the KERF 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 KERF once the Federal Aviation Administration (the "**FAA**") approved of North American's operations transfer to Georgia.

The Committee objected to the Debtors' characterization of the KERF Employees as "non-insiders." The Committee asserted that the KERF Employees have oversight authority over areas of North American's corporate policy consistent with the status of insiders. Therefore, the KERF 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 KERF 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 KERF Motion arguing that the Debtors failed to provide sufficient evidence to establish that one of the KERF 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 KERF Employees were reasonable from a "business judgment" perspective.

In overruling the Objections, the Court found sufficient evidence in the record to establish that the KERF Employees were not "insiders" of the Debtors (as defined in section 101(31)(B) of the Bankruptcy Code). Specifically, none of the KERF 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

**Lowenstein  
Sandler**  
ATTORNEYS AT LAW

### Contact Us

Sharon L. Levine, Esq.  
973.597.2374  
[slevine@lowenstein.com](mailto:slevine@lowenstein.com)

S. Jason Teele, Esq.  
973.597.2346  
[stelee@lowenstein.com](mailto:stelee@lowenstein.com)

Cassandra M. Porter, Esq.  
973.422.6538  
[cporter@lowenstein.com](mailto:cporter@lowenstein.com)

### Related Services

Bankruptcy, Financial  
Reorganization & Creditors' Rights

### Related Publications

Altering Unsecured Creditors'  
Committee Membership: No Easy  
Chore! 5/24/2012

Preference Relief for Real Estate  
Material and Service Providers  
5/1/2012

Using the "Safe Harbor" Defense to  
Defeat Preference Claims 5/1/2012

Using Public Information to Identify  
and React to the Early Warning  
Signs of a Financially Distressed  
Customer 4/4/2012

Got Setoff Rights? Think Again  
3/1/2012

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 (a) 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; (b) the KERP payment amount, which in the aggregate sought to pay the KERP Employees bonuses totaling \$137,031, was reasonable; (c) 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; (d) the KERP is consistent with the Debtors' prepetition bonus program; and (e) 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.

*Sharon L. Levine* and *S. Jason Teele* are Members and *Cassandra Porter* is Counsel in Lowenstein Sandler PC's *Bankruptcy, Financial Reorganization & Creditors' Rights Department*. They may be reached by calling 973-597-2500 or via email at [slevine@lowenstein.com](mailto:slevine@lowenstein.com), [steele@lowenstein.com](mailto:steele@lowenstein.com) and [cporter@lowenstein.com](mailto:cporter@lowenstein.com).

---

<sup>1</sup> *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](http://www.nyeb.uscourts.gov).

---

Send an e-mail to [addressupdate@lowenstein.com](mailto:addressupdate@lowenstein.com) if you would like to unsubscribe from this mailing list or update your contact information.

Lowenstein Sandler makes no representation or warranty, express or implied, as to the completeness or accuracy of the Alert and assumes no responsibility to update the Alert based upon events subsequent to the date of its publication, such as new legislation, regulations and judicial decisions. Readers should consult legal counsel of their own choosing to discuss how these matters may relate to their individual circumstances.

[www.lowenstein.com](http://www.lowenstein.com)

**New York**

1251 Avenue of the Americas  
New York, NY 10020  
212.262.6700

**Palo Alto**

390 Lytton Avenue  
Palo Alto, CA 94301  
650.433.5800

**Roseland**

65 Livingston Avenue  
Roseland, NJ 07068  
973.597.2500

© 2012 Lowenstein Sandler PC. In California, Lowenstein Sandler LLP