Feature

By Jeremy R. Fischer

GTAT: Noninsider Retention Plans Subject to Heightened Scrutiny

Debtors are often challenged to retain key, highly-skilled employees during a chapter 11 case. To combat this challenge, debtors and their professional advisors often develop and propose a "key employee retention plan" (KERP), which pays bonuses to noninsider employees to convince them to remain with the debtor during the reorganization process.

In 2005, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), Congress added § 503(c) to the Bankruptcy Code to limit bonus payments by debtors.[1] Since that time, the weight of authority has held that bonus payments intended to retain noninsider employees are subject to the "business-judgment" standard, regardless of whether the payments are scrutinized under § 363(b)(1) or 503(c)(3). In a recent bankruptcy appeal in New Hampshire, however, the district court not only held that § 503(c)(3) exclusively governs approval of noninsider KERPs, but also that the section's "facts and circumstances" test imposes a higher standard than mere "business judgment," requiring the bankruptcy court to make its own independent determination about whether the proposed KERP is justified in any particular case.[2]

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1 Section 503(c) of the Bankruptcy Code:
(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid —
(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that —
(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
(B) the services provided by the person are essential to the survival of the business; and
(C) either —
(I) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;
(2) a severance payment to an insider of the debtor, unless—
(A) the payment is part of a program that is generally applicable to all full-time employees; and
(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or
(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

2 *GT Advanced Techs. Inc. v. Harrington (In re GT Advanced Techs. Inc.)*, No. 15-cv-069-LM, 2015 WL 4459502 (D.N.H. July 21, 2015).

Background[3]

GT Advanced Technologies Inc. and its affiliates (collectively, the "debtors" and GTAT) are technology companies headquartered in Merrimack, N.H., that manufacture and market materials and equipment for the electronics, solar and LED industries. In the face of a severe liquidity crisis following the abrupt end to a high-stakes joint venture with Apple Inc., GTAT commenced chapter 11 cases in the U.S. Bankruptcy Court for the District of New Hampshire on Oct. 6, 2014. The debtors intended to wind down manufacturing operations related to the Apple venture, liquidate related equipment and reorganize around its other business lines.

Most of GTAT's highly skilled employees lived and worked within close proximity to the so-called "Route 128 Tech Corridor" that rings Boston. As a result of the debtors' uncertain future and an active job market in the local area, the debtors lost 43 employees to voluntary attrition within months of entering bankruptcy. Therefore, GTAT's management decided that a bonus plan was necessary to retain the workforce that would be necessary to successfully reorganize, and developed a KERP in consultation with its legal and financial professionals, including a compensation consultant and a newly formed "restructuring committee."

On Dec. 29, 2014, the debtors filed a motion in bankruptcy court seeking approval of the KERP and authorization of payments thereunder. Subsequently, the details were negotiated with key creditor constituencies, including the official committee of unsecured creditors, resulting in a modified KERP. No creditors objected; the only objections were lodged by the U.S. Trustee and a minor equityholder.

At the hearing on the KERP motion, the debtors submitted testimony from four witnesses: the debtors' financial advisor, compensation consultant, director of corporate compensation and an independent director who served on the restructuring committee. None of the objecting parties offered any written or testimonial evidence. At the conclusion of the hearing, the bankruptcy court issued an oral ruling denying the KERP motion, holding that the proposed KERP payments "are going to make no difference whatsoever ... as to their willingness to remain in the company's ... employ."[4]

3 The factual and procedural background can be found in the district court's appellate opinion. *Id.* at *1-3.

4 *Id.* at *3 (quoting transcript of bankruptcy court's oral decision).