Regulating Bankruptcy Bonuses and Protecting Workers in the Age of COVID-19
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Since March, executives of 18 large companies received over $135 million total in bonuses prior to their companies filing under Chapter 11, while "[t]hose same companies laid off tens of thousands of workers," according to a Washington Post report. These recent examples are illustrative of gaps left by the last major reform targeting bankruptcy bonuses, the Bankruptcy Abuse and Consumer Protection Act of 2005. Bankruptcy Code reforms to further regulate executive compensation have been introduced by U.S. House and Senate Democrats every few years since 2005. Referencing inequality and perceived abuses in the context of COVID-19, the House Committee on the Judiciary advanced the current House bill to the full chamber on September 29, 2020, marking the proposed legislation's furthest progress thus far. The bill deals not just with managerial bonuses but also employees and purpose.

H.R. 7370, the Protecting Employees and Retirees in Business Bankruptcies Act of 2020 (PERBB) would present significant changes to the Bankruptcy Code aimed at protecting workers, including:

- a greater level of claims for pre-petition pay, severance, and benefits being given priority under §507(a)(4) and (5) (increased to $20,000 in pay/severance *and* $20,000 in benefit plan contributions per employee, not limited to in time to the current 180-days before filing timeframe for the employee priority);
- post-petition severance pay owed to nonmanagement employees, employee benefit plan contributions, and damages for violations of any labor and employment laws becoming §503(b) administrative expenses;
- requiring post-petition compensation due to employees to be paid before secured claims;
- increased procedural and substantive hurdles for debtors seeking to modify collective bargaining agreements, §1113, and retiree benefits, §1114—modifications limited to the "minimum savings essential to permit the debtor to exit bankruptcy," such that liquidation or further financial reorganization is not likely to follow plan confirmation in the short-term;
- a new Chapter 11 purpose: "to preserve going concern value to the maximum extent possible through the productive uses of [debtor's] assets and the preservation of jobs that will sustain productive economic activity"—also added as a condition for plan confirmation;
- requiring a court approving §363 transactions to substantially weight the extent to which a prospective purchaser or lessee will preserve jobs, maintain employment terms and conditions, and assume or match pension and health benefit obligations to retirees.

The House bill's provisions related to executive compensation generally regulate payments to insiders, senior executive officers, the 20 highest compensated employees of the debtor who are not insiders or senior executives, department and division managers, and any consultants providing services to the debtor (hereinafter "management" for brevity). This is an expansion of the 2005 reforms which only targeted "insiders" (though insiders as currently defined in §101(31)(B) includes directors and officers). Proposed changes include:

- Under §1129 requirements for plan confirmation, disallowing payments to management *unless* (1) part of a program generally applicable to full-time employees and no more than 2 times the average payment to nonmanagement employees; or (2) for employment with the reorganized debtor, where not more than the median compensation for similar roles at comparable companies in the debtor's industry and not excessive in light of the economic losses of the debtor's non-management workforce;
- Expanding §503(c) limitation to disallow as administrative expenses any bonuses, enhanced compensation, or severance pay to management *unless* part of a general program for full-time employees and no more than 2 times mean payment to nonmanagement employees;
- Under §363(b), disallowing transfers to management if debtor discontinued or reduced severance pay for nonmanagement workforce on or after 1 year before date of filing;
- In a similar vein, providing that no deferred compensation arrangement or retiree benefits plan for management shall be assumed if a defined benefit plan for employees was terminated or if retiree benefits or employees' health benefits were reduced, respectively, on or after 1 year before filing;
- Providing for proportionate clawback of compensation paid to directors within 1 year before the date of filing and to the chair or lead director of the board when the debtor obtained relief under §1113 or §1114 relating to modification of a collective bargaining agreement or retiree benefit plan, or when the debtor terminated a defined benefit plan.

Through expanding the scope of executive compensation subject to restrictions under the Bankruptcy Code, PERBB may more effectively reduce management bonuses paid in bankruptcy where the 2005 reform merely "forced firms to style their bonus plans as 'incentive plans.'" However, the House version of PERBB fails to address bonus payments prior to filing for bankruptcy, a key issue identified at the outset of the post. The related Senate bill has an additional provision which would designate any transfer made to management "made in anticipation of bankruptcy" as a §547 preference avoidable by the trustee.

The full text of the House bill can be accessed here. A redline of relevant 11 U.S.C. provisions reflecting amendments proposed in H.R. 7370 is available here. The full text of Senate bill can be accessed here.

For related Roundtable posts, see Jared Ellias, Regulating Bankruptcy Bonuses; James H. M. Sprayregen, Christopher T. Greco, and Neal Paul Donnelly (Kirkland & Ellis), Recent Lessons on Management Compensation at Various States of the Chapter 11.