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No Seconds: Court Upholds Payments under KERP Program as Waiver of General Unsecured Claims Under Prepetition Retention Program

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July 30, 2018 - The District of Delaware Bankruptcy Court recently sustained the objection of the Litigation Trustee to the claims of three former employees (together, the "Claimants"), based on their participation in their employer's two-year retention program created prepetition (the "Prepetition Retention Program"). Opinion, *In re Old BPSUSH, Inc.*, No. 16-12373 (KJC) (Bankr. D. Del. June 1, 2018), D.I. 1635. Largely adopting the arguments of the Litigation Trustee, the court held that the Claimants had waived their right to receive payments under the Prepetition Retention Program due to their participation in the court-approved Key Employee Retention Plan ("KERP"), notwithstanding the Claimants' arguments that such waivers were unenforceable.

The Claimants were formerly employed by the Debtors. Prior to the commencement of their chapter 11 cases on October 31, 2016, the Debtors implemented the Prepetition Retention Program. *Id.* at *2 n.4. The Claimants each executed individual agreements, documenting their participation in the Prepetition Retention Program. *Id.* Among other things, the agreements provided that the Claimants would be entitled to a cash bonus if they remained with the Debtors for two years. *Id.* Such bonuses would vest on June 1, 2018. *Id.* at *10. However, the agreements also provided that, if the participating employee was terminated without cause within twelve months of a "change in control" of the Debtors, the award may vest sooner, provided that the Debtors' compensation committee approved the award. *Id.* at *10 & n.21.

On December 22, 2016, the Debtors moved for an order approving a Key Employee Incentive Plan and a KERP (the "KERP Motion"). *Id.* at *3. The court approved the KERP Motion on January 5, 2017. *Id.* Pursuant to the court's order, the Debtors sent letter agreements to eligible employees explicitly stating (i) the amount of his or her potential KERP award, *id.*, (ii) that such award was subject to the successful closing of a potential sale transaction

for substantially all of the Debtors' assets and the employee's continued employment in good standing until the payout date, *id.*, and (iii) that "payments received under the KERP will be in lieu of any payments [the eligible employee] may have been entitled to receive under the previous retention programs offered by the [Debtors] prior to commencement of their Chapter 11 . . . proceedings," *id.* at *4. Each of the Claimants executed such a letter agreement. After the sale transaction closed on February 27, 2017, the Debtors paid the Claimants their respective KERP bonuses in full. *Id.* at *4.

Nonetheless, after accepting the KERP bonuses, the Claimants filed claims for payments under the Prepetition Retention Program. The Litigation Trustee, authorized to do so under the Debtors' confirmed Plan, objected to the Claimants' claims, on the grounds that the Claimants had waived their right to receive payments under the Prepetition Retention Program based on their participation in the KERP program. *Id.* at *2. In response, the Claimants argued that there was no waiver for two primary reasons: first, the KERP letter agreements were novations that were not supported by new consideration; and second, the KERP letter agreements violated section 206.5 of the California Labor Code because they required the eligible employees to provide a release in return for wages due to them. *Id.* at *5.

The court, speaking to the Claimants' first argument, found that the Claimants had received new and valid consideration in exchange for the KERP payments. *Id.* at *7. Assuming that amounts were due under the Prepetition Retention Program, the court considered that such payments would have been payable as prepetition general unsecured claims, for which the payment amount would have been uncertain. *Id.* By signing the KERP letter agreements, the court found that the Claimants had exchanged their uncertain, prepetition, general unsecured claims for postpetition, administrative expense claims, which entitled the Claimants to payment well before general unsecured creditors. *Id.* Thus, the Claimants had received new value in both the certainty and timing of their payments, such that the KERP letter agreements constituted a valid novation of the individual agreements under the Prepetition Retention Program. *Id.*

Turning to the Claimants' arguments under the California Labor Code, the court concluded that KERP letter agreements did not violate the California Labor Code because the Claimants' right to payment under the Prepetition Retention Program had not vested at the time the Claimants signed the KERP letter agreements. *Id.* at *11. Because bonuses are considered "wages" under the applicable California Labor Code sections, the Claimants attempted to argue that the KERP letter agreements deprived them of their wages due under the Prepetition Retention Program. *Id.* at *9. The Litigation Trustee disputed that such "wages" were due, since payments under the Prepetition Retention Program did not become due until June 1, 2018. *Id.* at *9-10. The Claimants then resorted to the "change of control" provision in their individual agreements under the Prepetition Retention Program, which accelerated the vesting of their bonus awards to the date of the sale transaction, since such transaction constituted a "change of control." *Id.* at *10. The Litigation Trustee argued that, even if the "change of control" provision accelerated vesting of the Claimants' bonuses under the Prepetition Retention Program, such award was still contingent on the Debtors' discretion, as outlined in the "change of control" provision. *Id.* at *10-11. Accordingly, such amounts could not be considered due. *Id.* at *11. Considering California case law, the court agreed that, since all conditions on the awards under the Prepetition Retention Program had not been satisfied, such amounts were not due. *Id.*

Lastly, the court agreed with the Litigation Trustee that, even if the KERP letter agreements violated the California Labor Code, the California Labor Code was preempted by federal Bankruptcy Law, as enforced by the order of the Bankruptcy Court granting the KERP Motion. *Id.* at *11, 13.

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