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Update: Bankruptcy Court Denies \$20 Million Severance Payment to American Airlines CEO, Again

Overview

For the second time in six months, Judge Sean H. Lane of the United States Bankruptcy Court for the Southern District of New York declined to approve a \$20 million severance payment to Thomas Horton, Chief Executive Officer of AMR Corporation. Earlier this year, as described in our April 18, 2013 [client alert](#), Judge Lane reviewed and denied the Horton severance payment as part of the \$11 billion merger of US Airways and AMR Corporation but he left open the possibility -- without expressing a view -- of pursuing such a payment under the chapter 11 plan. In a September 13, 2013 [decision](#), Judge Lane reviewed the same \$20 million severance payment, this time included as part of AMR Corporation's plan of reorganization, and, while confirming the plan of reorganization, again denied the severance payment.¹

Background

For the reasons we reported in our previous alert, Judge Lane found that the \$20 million severance payment did not comply with the requirements set forth in Section 503(c)(2) of the Bankruptcy Code. As they did in attempting to have Judge Lane approve the severance applying the business judgment standard of Section 363 in connection with the merger back in March, the AMR debtors here sought to replace the strict standards of Section 503(c)(2) with the more relaxed confirmation standards in Section 1129. Specifically, Section 1129(a)(4) establishes that payments made pursuant to a plan of reorganization must be reasonable.²

The United States Trustee again objected to the severance on the grounds that it violated Section 503(c), this time in the plan context. The Trustee also objected to the wholly separate payments of creditors committee members' professional fees pursuant to the plan absent satisfaction of Section 503(b), but the Bankruptcy Court overruled that objection and allowed the payments.

¹ *In re AMR Corp.*, 2013 Bankr. LEXIS 3809 (Bankr. S.D.N.Y. Sept. 13, 2013)

² Section 1129(a)(4) provides that: "Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable." 11 U.S.C. §1129(a)(4).

Decision

Judge Lane first approved the reimbursement of professional fees, finding that a showing of substantial contribution under Section 503(b) is not the exclusive avenue for the reimbursement of fees and does not foreclose the possibility of a consensual payment of reasonable fees under a plan pursuant to Section 1129(a)(4) and Section 1123(b)(6).³ By contrast and consistent with his holding in March, he then denied the Horton severance payment because he found satisfaction of Section 503(c)(2) to be the exclusive mechanism for approval of a severance payment to an insider.

The Bankruptcy Court concluded that the specific language of Section 503(c)(2) left no doubt that insider severance “shall neither be allowed, nor paid” unless approved under that provision. Judge Lane found that Section 503 must be applied notwithstanding that: (i) the severance would be paid post-emergence from the non-estate funds of the merger-created Newco, (Judge Lane's problem with this was the payment was a condition precedent to plan effectiveness and would be paid automatically by Newco), and (ii) the severance contained post-emergence provisions, such as an ongoing board salary, (Judge Lane saw these non-severance provisions as severable from the issue in contention). In addition, the Bankruptcy Court rejected the argument that the severance payment deserved special consideration because Newco needed to make the payment in order to secure Mr. Horton’s continued involvement. If the payment was indeed important to the success of Newco, the Bankruptcy Court countered, then the payment could be authorized and paid for solely by the board of Newco post-emergence, without bankruptcy court involvement and free of the restrictions of the Bankruptcy Code -- to do otherwise requires satisfaction of Section 503(c). Finally, the court also concluded (in dicta) that the severance payment would not meet the reasonableness standard of 1129(a)(4), even if such standard were to be applied.

Conclusion

Contractual agreements to pay severance, even post emergence, will be more difficult based on this decision and the strictures imposed by section 503(c). Careful planning and consideration must be given when severance protection for insiders is desired by creditors or other parties in the aftermath of the 2005 BAPCPA revisions to Section 503(c).

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³ Section 1123(b)(6) provides that “...a plan may - ... include any other appropriate provision not inconsistent with the applicable provisions of this title.” 11 U.S.C. §1123(b)(6).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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