The Deal

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# DECIPHERING DANA

## WHAT DO KERPS AND DUCKS HAVE IN COMMON—AND WHEN CAN THEY BE ALLOWED TO SURVIVE UNDER THE BANKRUPTCY REFORM BILL?

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After Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, or BAPCPA, with its new provisions severely limiting a debtor's ability to pay its insiders retention and severance payments, key employee retention programs, or Kerps, were all but declared dead.

Could conventional Kerps simply reappear as incentive-based compensation programs with similar goals—the retention of key employees—but different names? At least one bankruptcy court has said no. In **Dana Corp.**, the judge opined that "[i]f it walks like a duck [Kerp] and quacks like a duck [Kerp], it's a duck [Kerp]."

Before BAPCPA, courts routinely authorized Kerps as necessary tools for bankrupt companies to retain their key employees and, thus, as a sound exercise of the debtor's business judgment. BAPCPA changed all of that. Newly enacted section 503(c) of the Bankruptcy Code, targeted specifically at insider severance and retention payments, heightened dramatically the debtor's burden of proof needed when paying senior executives to stay with the company. It also capped such payments, tying them to those afforded "rank-and-file" employees.

Specifically, new section 503(c)(1) permits retention payments to an executive only if the payment is necessary because the executive has a "bona fide job offer from another business" for at least equivalent compensation and if the services that the executive provides "are essential to the survival of the business. The amount of the payment cannot exceed 10 times the amount of the mean of similar payments paid to nonmanagement employees during the year of such payment, or if no such payments were made, then such payment cannot exceed an amount equal to 25% of the amount of any similar payments made to the executive during the year before the year of such payment.

Congress also took on severance payments to insiders, a common tag-along feature of Kerps. BAPCPA prohibits such payments unless the payments are part of a program open to all employees and if the amount does not exceed 10 times an amount equal to the mean severance paid to nonmanagement employees during the year in which the payment is to be made.

Section 503(c) focuses on retention and severance payments to insiders. Can a debtor therefore obtain approval of a performance-based, rather than retention-centric, compensation plan? The plain language of section 503(c) seemingly permits this result. The Dana decision, however, demonstrates that a debtor cannot simply call something an "incentive plan" and expect it to fall outside BAPCPA's restrictions.

The Dana court analyzed whether the debtor's proposed compensation plan for its most senior executives constituted a "pay to stay" Kerp-like program subject to BAPCPA's stringent requirements or, rather, a "produce value for pay" incentive plan reviewable under the traditional business judgment rule.

Dana's plan proposed paying key executives a fixed bonus when Dana's reorganization plan took effect, regardless of performance or creditor recovery. It also included a performance-driven variable bonus based on Dana's value at some future time. For example, Dana's CEO would receive $4,133,000 if Dana's value dropped by 23%, or $2 billion, and would get more if its value increased.

Creditors challenged the variable payment as an artificially low threshold that guaranteed payment of the bonuses, making them more like retention payments than true performance-based compensation. Dana's plan also included a component under which the CEO agreed to execute an 18-month noncompete agreement in exchange for monthly payments of $166,666.67 during that period if the CEO were involuntarily terminated without cause or resigned "for good reason."

Dana argued that its proposed plan was incentive-based and not subject to the retention and severance provisions of section 503(c). The bankruptcy court (Lifland) disagreed. Looking to the substance of the plan, the court held that "this compensation scheme walks, talks and is a retention bonus." It found that the plan was not an incentive bonus plan if the executives earned their bonuses merely by staying until a certain date. It also found that Dana's payments to its CEO in consideration for his agreement to enter into a noncompete agreement was a severance payment.

The Dana court limited its holding to the particular plan under consideration. It expressly left open the possibility that a true incentive plan could be viable under BAPCPA, even if it contained some retentive elements.

Of course, Dana reflects just one court's view of section 503(c). The critical takeaway from the case with universal application, however, is this: To pass muster and avoid the stringent requirements of section 503(c), a compensation plan must, both in form and substance, be a true incentive or performance-based compensation plan.

Merely labeling it as one is not enough. If it walks like a duck and talks like a duck, it's a duck. ■

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