UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK		**Hearing Date: June 11, 2020** **Hearing Time: 2:00 pm**
In re	:	Chapter 11
AVIANCA HOLDINGS S.A., *et al.*,	:	Case No. 20-11133 (MG)
Debtors.	:	Jointly Administered

OBJECTION OF THE UNITED STATES TRUSTEE TO ENTRY OF ORDER AUTHORIZING THE DEBTORS TO PAY WAGES, COMPENSATION, EMPLOYEE BENEFITS AND RELATED RELIEF

TO: **THE HONORABLE MARTIN GLENN,**
UNITED STATES BANKRUPTCY JUDGE:

William K. Harrington, the United States Trustee for Region 2 (the "United States Trustee"), hereby submits this objection (the "Objection") to the Debtors' Motion For An Order Pursuant To Sections 363(B), 507, And 105(A) Of The Bankruptcy Code (I) Authorizing, But Not Directing, The Debtors To (A) Pay Prepetition Wages, Compensation And Employee Benefits And (B) Continue Payment Of Wages, Compensation, Employee Benefits And Related Administrative Obligations In The Ordinary Course Of Business; And (II) Authorizing And Directing Applicable Banks And Financial Institutions To Process And Pay All Checks Presented for Payment And To Honor All Funds Transfer Requests Made By The Debtors (the "Wage Motion"). ECF Doc. No. 3. In support of his Objection, the United States Trustee respectfully submits as follows:

PRELIMINARY STATEMENT

The Debtors seek authority from this Court in order (a) to pay approximately $3.8 million in amounts earned prepetition, but not paid, pursuant to an Incentive Plan, (b) to pay prepetition

severance payments in undisclosed amounts, and (c) to pay postpetition awards of approximately $1.2 million pursuant to a Retention Plan,.

The Wage Motion seeks to authorize postpetition payments for the third and fourth quarter of 2020 of approximately $1.2 million under the Retention Plan and undisclosed postpetition amounts under the Severance Plan to what the Debtors call "non-insiders" without describing the participants or details regarding the plan payments (while the Debtors have provided information regarding the payments under the Retention Plan, the information has not been made public). The Debtors have not (a) moved under, addressed or provided any evidence that satisfies the requirements of Bankruptcy Code Section 503(c) with respect to the retention and severance programs or (b) provided enough information for the Court and parties in interest to evaluate the payments under those programs. The Debtors' characterization of non-insiders should be subject evaluation by parties in interest and the Court.

The United States Trustee objects to those portions of the Wage Motion relating to payments under the incentive and severance plans that do not comply with the limitations set forth in 11 U.S.C. § 507(a)(4) and are not justified under the doctrine of necessity. Section 507(a)(4) limits priority payments to amounts earned within 180 days of the filing of the petition up to the cap of $13,650. The Wage Motion seeks to make incentive and severance payments to individuals who may have earned those incentive or severance prepetition payments over 180 days prior to the filing of the petition and/or who may be receiving payments that exceed the statutory priority cap. The Debtors have represented to the United States Trustee that the Debtors do not expect to make any payment in excess of the priority cap, but that representation is inadequate without a commitment to provide information regarding the applicable earning period and any excess payments. The Debtors must also explain how payments to retired

employees and to current employees whose incentive and/or severance payments were earned but unpaid in prior years, dating back to 2018 (or beyond the 180 day period), meet the immediate and irreparable harm that justifies the application of the doctrine of necessity.

BACKGROUND

General Background

1. Avianca Holdings S.A. and its affiliated entities ("Avianca" or the "Debtors") commenced voluntary cases under chapter 11 of the Bankruptcy Code on May 10, 2020 (the "Petition Date").

2. The Debtors are authorized to continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

3. The Debtors' chapter 11 cases are being jointly administered for procedural purposes only pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure. ECF No. 73.

4. Avianca is the second-largest airline group in Latin America and the most important carrier in the Republic of Colombia and in the Republic of El Salvador. It is a codeshare partner of United Airlines and a member of the 26 member Star Alliance, the world's largest global airline alliance. *See* Declaration of Adrian Neuhauser in Support of Chapter 11 Petitions and First Day Pleadings (the "Neuhauser Declaration"), ECF No. 20, ¶ 3.

5. Avianca offers passenger service on more than 5,350 weekly flights to more than 76 destinations in 27 countries. Avianca employs approximately 18,900 employees and generates approximately $3.9 billion in annual revenues. *Id.* at ¶ 5.

6. The Debtors commenced these cases because of the COVID-19 pandemic, which has resulted in restrictions on commercial flights and reductions on travel, leading to a severe loss of revenue. *Id*. at ¶ 7.

7. On the Petition Date, the Debtors filed the Wage Motion, seeking to continue their "Incentive Plans," (*Id.* at ¶¶ 30-3), "Retention Plan," (*Id.* at ¶ 34), and "Severance Plan" (*Id.* at ¶¶ 79-82).

8. With respect to the Incentive Plan periods prior to the Petition Date, the Debtors estimate the ***prepetition*** gross obligations payable to be approximately $3.8 million. *Id.* at ¶ 33.

9. With respect to the Retention Plan the Debtors seek authorization to pay ***postpetition*** awards for the third and fourth quarters of 2020 as follows:

> 34. The Debtors also maintain a retention plan with respect to approximately 34 of its non-insider Employees (the "Retention Plan"). The total award amounts for Employees under the Retention Plan range from 30% to 50% of the covered Employees' salaries, with cash payments made quarterly to applicable Employees who remain in good standing. Participants whose employment is terminated voluntarily or for cause before payment of any amounts (i.e., before the end of a quarter) are not eligible to receive any further retention awards under the Retention Plan. The Debtors estimate the approximately $1.25 million in prepetition obligations remain outstanding under the Retention Plan. The Debtors seek the authority to continue the Retention Plan at their reasonable discretion and consistent with their prepetition practices in order to retain valuable Employees and preserve employee morale as the Debtors seek to implement a successful reorganization.

Id. at 34.

10. With respect to the Severance Plan the Debtors seek to honor both prepetition and postpetition severance obligations in the ordinary course of business at their sole discretion, except to the extent any such severance amounts are not in compliance with Section 503(c)(2) of the Bankruptcy Code. *Id.* at ¶¶ 79-82.

ARGUMENT

The Debtors have moved under sections 105(a), 363(b) and 507 for approval of the relief sought in the Wage Motion. Absent additional information, however, the Court and parties in interest cannot determine whether the proposed Retention Plan is an ordinary course transaction or covers "insiders", thus taking it out of the purview of sections 363 and 503(c)(3).

A. The Governing Law

1. Section 101(31)

Section 101(31)(B) of the Bankruptcy Code provides in relevant part:

(31) The term "insider" includes --

(B) if the debtor is a corporation –

(i) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;
(iv) partnership in which the debtor is a general partner
(v) general partner of the debtor; or
(vi) relative of a general partner, director, officer, or person in control of the debtor;

11 U.S.C. § 101(31)(B)(i)-(iv).

2. Section 503(c)

Section 503(c) of the Bankruptcy Code provides, in relevant part:

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 debtors' 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.

11 U.S.C. § 503(c).

As an initial matter, Section 503(c)(1) must be applied to any contemplated transfer that is being made for the benefit of an insider of a debtor after the Petition Date. Once it is determined that the individual who will receive the transfer is an insider, no transfer can be made where the transfer is being made for the purpose of inducing the person to remain with the debtor's business, unless the factors set forth in Sections 503(c)(1)(A) and (B) are met and either one of the mathematical formulas set forth in (C)(i) or (C)(ii) has been satisfied.

Congress added Section 503(c) in 2005 to curtail payments of retention incentives to insiders to "'eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process.'" *In re Residential Capital LLC*, 478 B.R. 154, 169 (Bankr. S.D.N.Y. 2012) ("*Rescap*") (quoting *In re Global Home Prods., LLC*, 369 B.R. 778, 784 (Bankr. D. Del. 2007)); *accord In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 312-13 (Bankr. S.D.N.Y. 2012); *In re Velo Holdings, Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012). In addition, Congress intended to limit the scope of key employee retention plans and other programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor. *Rescap*, 478 B.R. at 169. Congress intended to put into place "a set of challenging standards" for debtors to overcome before retention bonuses could be paid. *Global Home*, 369 B.R. at 784. The proponent of a bonus plan has the burden of showing that the plan is not a retention plan governed by Section 503(c)(1). *Hawker Beechcraft*, 479 B.R. at 313; *Rescap*, 478 B.R. at 170.

Where Section 503(c)(1) applies, the transfer cannot be justified solely on the debtor's business judgment. *See In re Borders Group., Inc.*, 453 B.R. 459, 470-71 (Bankr. S.D.N.Y. 2011). If a proposed transfer falls within Section 503(c)(1), then the business judgment rule does not apply, regardless of whether a sound business purpose may actually exist. *In re Dana Corp.*, 351 B.R. 96, 101 (Bankr. S.D.N.Y. 2006) ("*Dana I*"). Further, a debtor's label of a plan as incentivizing to avoid the strictures of Section 503(c)(1) must be viewed with skepticism; rather, the circumstances under which the proposal is made and the structure of the compensation package control. *Velo Holdings*, 472 B.R. at 209 ("Attempts to characterize what are essentially prohibited retention programs as 'incentive' programs in order to bypass the requirements of section 503(c)(1) are looked upon with disfavor, as the courts consider the circumstances under

which particular proposals are made, along with the structure of the compensation packages"); *see also Hawker Beechcraft*, 479 B.R. at 313 ("The concern ... is that the debtor has dressed up a KERP to look like a KEIP in the hope that it will pass muster under the less demanding 'facts and circumstances' standard in ... §503(c)(3)."); *Dana I*, 351 B.R. at 102 n.3 ("If it walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP).").

Finally, not only must bonus plans comply with Section 503(c), but as administrative expenses they must also be "actual, necessary costs and expenses of preserving the estate," as required by Section 503(b).

B. The Debtors Have Failed to Establish that the Participants in the Retention Plan are Not Subject to Section 503(c)(1)[1]

Under the Bankruptcy Code, officers and directors are "insiders" of a corporate debtor. 11 U.S.C. § 101(31)(B). The Debtors assert that none of the participants are insiders; however, aside broad statements to that effect, the Debtors have not advanced any information on the identity or title of the individuals who would be covered by the programs they are seeking to get approved.[2] The definition of "insider" includes directors and officers, although the definition is not exhaustive. See Section 101(31)(B)(i)-(vi). *See also Borders*, 453 B.R. at 469 ("[i]nsider status can also be determined on a case by-case basis based on the totality of the circumstances, including the degree of an individual's involvement in a debtor's affairs"); *Office of the United States Trustee v. Fieldstone Mortgage Co.*, 2008 WL 4826291. *5 (D. Md. Nov. 4, 2008)

[1] While the Wage Motion contemplates the postpetition continuation of the Incentive Plan, the Debtors have advised that they no longer seek such relief. The Debtors have also advised that the all wage, prepetition incentive payments, and severances do not exceed the priority cap under Section 507(a)(4). The United States Trustee reserves his right to object to the postpetition continuance of the Incentive Plan and/or to the prepetition Incentive Plan payments should the Debtors alter their position.

[2] The Debtors have provided details regarding the Retention Plan on a confidential basis but have not made the information publicly available.

("[C]ontrol . . . is an independent additional ground for finding a person an insider, not a feature that officers or directors are required to possess in order to be deemed insiders"); *In re Krehl*, 86 F.3d 737, 741 (7th Cir. 1996) (definition of insider is illustrative rather than exhaustive); compare *In re Kunz*, 489 F.3d 1072 (10th Cir. 2007) (it is not simply the title "director" or "officer" that renders an individual an insider; rather it is the set of legal rights that a typical corporate director or officer holds). The confidential disclosure to the United States Trustee that some of the covered employees are director and officer level emphasizes the need for further information on the record to support the claimed non-insider status of the covered employees.

Other than the Debtors' bare assertion that the employees are not insiders, the Debtors have provided no evidence, submitted no declaration or affidavit under penalty of perjury, filed no information on the docket or, to the knowledge of the United States Trustee, provided any information to the Court that would allow the Court to make an informed judgment as to the insider status of these alleged non-insiders. The Debtors' conclusory statement does not rebut the presumption of insider status absent a complete disclosure of the titles, roles, and responsibilities of each employee.

The Debtors have therefore failed to meet their burden to prove that none of the employees are "insiders" within the meaning of Section 101(31) of the Bankruptcy Code and are therefore not subject to the strictures of Section 503(c)(1).

C. Even if the Retention Plan Is Governed by Sections 503(c)(3) and Section 363, It is Still Deficient

If the Court finds that Section 503(c)(1) does not apply, the Court may also consider whether the payments are permissible under section 503(c)(3). *See In re Dana Corp.*, 358 B.R. 567, 576 (Bankr. S.D.N.Y. 2006) ("*Dana II*"). Section 503(c)(3) authorizes judicial discretion

with respect to bonus plans motivated primarily by reasons other than retention. *See id*. Should the Court find that Section 503(c)(1) does not apply, the Court must then find that these incentive and severance plans pass the test of Section 503(c)(3) – that they are necessary to preserve the value of the Debtors' estates, and are "justified by the facts and circumstances of the case." 11 U.S.C. § 503(c)(3).

Here, the Debtors have not provided any information for the Court to make this determination. In connection with the Retention Plan, the Debtors seek approval as part of the Wage Motion, although the Debtors have not publicly provided any evidence to establish the historical nature or any evidence to allow the Court undertake a proper evaluation of the terms. For example, the Debtors have not set forth on the record (i) how long they have maintained the Retention Plan, (ii) the detailed metrics for qualifying for retention payments, (iii) the titles of the covered participants, (iv) the duties of covered participants, or (v) to whom they report.

Accordingly, until the record has been supplemented and these issues are addressed, the Court does not have enough information to determine whether the Debtors have met the appropriate statutory criteria, and the continuation of the Retention Plan should be denied.

D. The Debtors Should Not be Permitted to Make Postpetition Severance Payments to Non-Insiders Without a Determination that Section 503(c) is not Implicated.

The Wage Motion seeks authority to continue the Debtors' Severance Plan during the postpetition period. As in the case of the Debtors' attempt to pay non-insiders under the Retention Plan, the Debtors take the position that approval to continue the Debtors' Severance Plan postpetition would entitle the Debtors to pay severance to non-insiders without notice and without filing a separate motion pursuant to Section 503(c). As discussed above, the Debtors'

characterization of non-insiders should be subject to evaluation by parties in interest as well as the Court.

E. Additional Information Is Required Before the Debtors Are Authorized to Pay Employees on account of Prepetition Compensation and Benefits Program Over the Statutory Cap of $13,650.

The Wage Motion seeks authority to pay approximately $3.8 million in Incentive Plan payments that were earned, but not paid prior to the Petition Date as wells as severance payments incurred prior to the Petition Date. While the Wage Motion does not describe whether the Debtors seek to pay amounts in excess of $13,650 to any employee, the Debtors have represented to the United States Trustee that it is expected that no employee will receive more than the statutory priority cap set forth in Section 507(a)(4) of the Bankruptcy Code.

The United States Trustee objects to those portions of the Wage Motion relating to payments under the incentive and severance plans that do not comply with the limitations set forth in 11 U.S.C. § 507(a)(4) and cannot be justified under the doctrine of necessity. Section 507(a)(4) limits priority payments to amounts earned within 180 days of the filing of the petition up to the cap of $13,650. The Wage Motion seeks authority to make incentive and severance payments without disclosing whether any such payments will made to any individuals who earned the payment outside of 180 days of the petition and/or whether any payments to any individuals will exceed the statutory priority cap. To the extent any such payments are contemplated, the United States Trustee objects. Although the Debtors have represented to the United States Trustee that the Debtors do not expect to make any payment in excess of the priority cap, that representation is inadequate without a commitment to provide information regarding the applicable earning period and any excess payments. The Debtors must also meet their burden of proof to demonstrate how payments to retired employees and to current

employees whose incentive and/or severance payments were earned but unpaid in prior years, dating back to 2018 (or beyond the 180 day period), meet the standard of immediate and irreparable harm that justifies the application of the doctrine of necessity.

WHEREFORE, the United States Trustee respectfully requests that the Court sustain his objections and grant such other relief as is just.

Dated: New York, New York
June 4, 2020

Respectfully submitted,

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UNITED STATES TRUSTEE, Region 2

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