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CREDITOR'S RIGHTS TOOLKIT

Should I Remain Employed by the Debtor? What to Know About KEIPs and KERPs

For a debtor in financial distress, having the right team in place to steward the company through a restructuring can mean the difference between success and failure. To incentivize top talent to stay with the debtor and continue to perform through a Chapter 11 case, debtors may implement one or more so-called "key employee retention plans" (KERPs) or "key employee incentive plans" (KEIPs). These plans are frequently designed by outside compensation consultants based on lists of proposed participants and objectives provided by management.

A participant in a KEIP or KERP can often expect a meaningful bonus payment upon achieving certain retention or performance metrics, which can help to compensate for some of the uncertainty, disruption, and excess workload that comes with working at a company in bankruptcy. When slated for participation in a KEIP or KERP, an employee, whether they serve as a member of senior management or among the rank-and-file, should consider opportunity costs, likelihood of success in Chapter 11, and degree of risk tolerance when considering whether to stay or leave.

Key Issues

- **KEY EMPLOYEE RETENTION PLANS**
  Section 503(c)(1) of the Bankruptcy Code prohibits a debtor from making payments to an insider employee (generally senior management) to induce the employee to remain with the company unless such payments meet certain stringent requirements, including that such insider already has a bona fide offer in hand from another employer. Accordingly, KERPs or "stay bonuses," are commonly implemented for noninsider employees to incentivize them to stay with the company through a future date, usually tied to restructuring milestones such as completion of a sale or confirmation of a plan of reorganization. KERP payments are usually approved under Sections 503(c)(3) and 363(b) of the Bankruptcy Code, which apply a more lenient standard than Section 503(c)

(1) that is based on facts and circumstances of the case and the debtor's "business judgment." KERP payments may be made in multiple installments and may be expressed as a percentage of the employee's annual compensation or a flat amount. Upfront retention awards are sometimes paid prior to a bankruptcy filing and are subject to clawback if the employee leaves before the applicable retention milestones. KERP payments may also be conditioned on receipt by the debtor of a release from the participating employee of any bonus amounts to which they would otherwise be entitled outside of a Chapter 11.

- **KEY EMPLOYEE INCENTIVE PLANS**
  To avoid having to meet the stringent requirements of Section 503(c)(1) of the Bankruptcy Code, incentive payments to insiders are made under a KEIP rather than a KERP. A KEIP is typically a plan providing for payment of a bonus to senior management upon hitting certain performance targets, which are commonly tied to things like achieving certain financial metrics; selling assets by a specified time and/or above an existing bid amount; or confirmation of a plan of reorganization by a specified time. In order to pass muster with the Bankruptcy Court, these targets must be relatively difficult to achieve, so executives can't merely stick around (which would push the plan into the realm of Section 503(c)(1)) or rely on "lay-up" targets to collect their bonuses. The idea is that properly incentivized executives will continue to work hard for the health of the business and maximize returns to all stakeholders, even if the business will be sold or come under new ownership as part of the Chapter 11 process. Like a KERP, however, KEIP participants typically will be required to forego bonuses under pre-bankruptcy programs or employment contracts as a condition to participation in the KEIP.

Takeaway

Before deciding to remain employed by a company in bankruptcy in reliance on a KEIP or KERP, it is important that an employee consult with experienced bankruptcy counsel to understand the risk that a restructuring, sale, or other condition to payment may not be successful or occur (and thus the payments won't materialize). The employee will also want to consider the opportunity cost of staying with the company while in bankruptcy, which could lead to different or increased responsibilities that weren't part of the original job description and delay them from finding a position with another company.