

# Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

SEPTEMBER 2020

**EDITOR'S NOTE: DEBT CANCELLATION INCOME**

Victoria Prussen Spears

**AN OVERVIEW OF THE RULES REGARDING THE REALIZATION  
AND RECOGNITION OF DEBT CANCELLATION INCOME—PART I**

Thomas J. Gallagher and Dennis L. Cohen

**TOP 10 QUESTIONS HUMAN RESOURCES MAY HAVE WHEN  
THEIR COMPANY IS FILING FOR CHAPTER 11 PROTECTION**

H. Andrew Matzkin, Kaitlin R. Walsh, and William W. Kannel

**CARES ACT EXPANDS SIMPLER BANKRUPTCY RESTRUCTURING UNDER  
NEW SUBCHAPTER V TO BUSINESSES WITH UP TO \$7.5 MILLION IN DEBT**

Evan M. Jones and Jennifer Taylor

**BANKRUPTCY IMPLICATIONS FOR COMMERCIAL LANDLORDS  
WITH BANKRUPT OR NEAR-BANKRUPT TENANTS**

Amy Simon Klug and Meg Raker

**DON'T OPEN TILL DOOMSDAY: FDI SCREENING IN THE EU—  
A CURE FOR A COVID-19-STRUCK ECONOMY?**

Christian Peeters

**TEXAS APPEARS POISED TO ABANDON THE PONZI SCHEME PRESUMPTION**

Michael J. Summerhill and Tevin Hopkins

**TEXAS BANKRUPTCY COURT DENIES REJECTION OF CERTAIN  
PRODUCTION DEDICATION MIDSTREAM AGREEMENTS**

Jim Prince and Scott Looper

**DELAWARE BANKRUPTCY COURT VOIDS PREFERRED  
STOCKHOLDER'S RIGHT TO BLOCK BANKRUPTCY FILING**

Stephen B. Selbst and W. Conor Anderson



LexisNexis

# Pratt's Journal of Bankruptcy Law

---

VOLUME 16

NUMBER 6

September 2020

---

<b>Editor's Note: Debt Cancellation Income</b> Victoria Prussen Spears	261
<b>An Overview of the Rules Regarding the Realization and Recognition of Debt Cancellation Income—Part I</b> Thomas J. Gallagher and Dennis L. Cohen	264
<b>Top 10 Questions Human Resources May Have When Their Company Is Filing for Chapter 11 Protection</b> H. Andrew Matzkin, Kaitlin R. Walsh, and William W. Kannel	280
<b>CARES Act Expands Simpler Bankruptcy Restructuring Under New Subchapter V to Businesses with up to \$7.5 Million in Debt</b> Evan M. Jones and Jennifer Taylor	286
<b>Bankruptcy Implications for Commercial Landlords with Bankrupt or Near-Bankrupt Tenants</b> Amy Simon Klug and Meg Raker	290
<b>Don't Open Till Domsday: FDI Screening in the EU—A Cure for a Covid-19-Struck Economy?</b> Christian Peeters	298
<b>Texas Appears Poised to Abandon the Ponzi Scheme Presumption</b> Michael J. Summerhill and Tevin Hopkins	307
<b>Texas Bankruptcy Court Denies Rejection of Certain Production Dedication Midstream Agreements</b> Jim Prince and Scott Looper	312
<b>Delaware Bankruptcy Court Voids Preferred Stockholder's Right to Block Bankruptcy Filing</b> Stephen B. Selbst and W. Conor Anderson	316

**QUESTIONS ABOUT THIS PUBLICATION?**

---

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D., at ..... 415-908-3207  
Email: ..... kent.hanson@lexisnexis.com  
Outside the United States and Canada, please call ..... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at ..... (800) 833-9844  
Outside the United States and Canada, please call ..... (518) 487-3385  
Fax Number ..... (800) 828-8341  
Customer Service Website ..... <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or ..... (800) 223-1940  
Outside the United States and Canada, please call ..... (937) 247-0293

---

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

**Example:** Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2020 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved.

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

Editorial Office  
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862  
[www.lexisnexis.com](http://www.lexisnexis.com)

MATTHEW  BENDER

# *Editor-in-Chief, Editor & Board of Editors*

---

## **EDITOR-IN-CHIEF**

**STEVEN A. MEYEROWITZ**

*President, Meyerowitz Communications Inc.*

## **EDITOR**

**VICTORIA PRUSSEN SPEARS**

*Senior Vice President, Meyerowitz Communications Inc.*

## **BOARD OF EDITORS**

**SCOTT L. BAENA**

*Bilzin Sumberg Baena Price & Axelrod LLP*

**ANDREW P. BROZMAN**

*Clifford Chance US LLP*

**MICHAEL L. COOK**

*Schulte Roth & Zabel LLP*

**MARK G. DOUGLAS**

*Jones Day*

**MARK J. FRIEDMAN**

*DLA Piper*

**STUART I. GORDON**

*Rivkin Radler LLP*

**PATRICK E. MEARS**

*Barnes & Thornburg LLP*

*Pratt's Journal of Bankruptcy Law* is published eight times a year by Matthew Bender & Company, Inc. Copyright © 2020 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 9443 Springboro Pike, Miamisburg, OH 45342 or call Customer Support at 1-800-833-9844. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, [smeyerowitz@meyerowitzcommunications.com](mailto:smeyerowitz@meyerowitzcommunications.com), 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to lawyers and law firms, in-house counsel, government lawyers, senior business executives, and anyone interested in privacy and cybersecurity related issues and legal developments. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

# Top 10 Questions Human Resources May Have When Their Company Is Filing for Chapter 11 Protection

*By H. Andrew Matzkin, Kaitlin R. Walsh, and William W. Kannel\**

*The unprecedented economic challenges caused by the COVID-19 pandemic have forced businesses across the country to consider bankruptcy. This article provides a high-level view of issues to be considered by human resources when considering filing for Chapter 11 bankruptcy.*

Businesses in a wide range of industries may now be forced to consider bankruptcy given the unprecedented economic challenges caused by the COVID-19 pandemic. This article is designed to provide a high-level view of issues to be considered by human resources when considering filing for Chapter 11 bankruptcy. This article focuses specifically on a Chapter 11 bankruptcy (pursuant to which a business will be reorganized) rather than Chapter 7 bankruptcy (pursuant to which a business will be liquidated).

In a Chapter 11 proceeding, the company continues to operate its business as a “debtor-in-possession.” The debtor-in-possession’s goal is to turn itself around financially and restructure its financial obligations, rather than liquidate its assets, although sometimes a Chapter 11 is filed to sell the company’s assets as a going concern. Immediately upon the filing of a bankruptcy petition (frequently referred to as the “Petition Date”), the debtor company is entitled to the benefit of an “automatic stay” that prevents creditors from continuing or taking actions against it, including actions to enforce claims that arose prior to the filing. This gives the debtor a “breathing spell” during which it may continue to operate in the ordinary course of its business and seek to reorganize.

## **1. CAN A COMPANY IN CHAPTER 11 MAKE WAGE PAYMENTS TO ITS EMPLOYEES AND OFFER HEALTH BENEFITS TO ITS EMPLOYEES?**

Yes. A debtor-in-possession maintains the ability to pay employees and offer

---

\* H. Andrew Matzkin (hmatzkin@mintz.com) is member of the firm and an employment litigator at Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., providing counsel on labor and employment issues. Kaitlin R. Walsh (krwalsh@mintz.com) is special counsel at the firm practicing bankruptcy law with a focus on corporate restructurings and insolvencies. William W. Kannel (bkannel@mintz.com) is a member of the firm and chair of its Bankruptcy & Restructuring Practice representing both creditors and debtors in all phases of distressed debt negotiations, bankruptcy litigation, and distressed asset acquisitions.

health benefits in the ordinary course of its business. If, however, the company was not able to pay all amounts owing to its employees *prior* to the Petition Date, then it is required to obtain permission from the bankruptcy court in order to pay those “pre-petition” wages and benefits following the Petition Date (the period after the filing of the bankruptcy petition is generally referred to as “post-petition”).

## **2. CAN A COMPANY IN CHAPTER 11 MAKE BASIC DECISIONS REGARDING WORK TERMS AND CONDITIONS AND RELATED HUMAN RESOURCES MATTERS?**

Yes. A debtor-in-possession is generally entitled to conduct operations, including in relation to its employees, in the ordinary course of its business following the Petition Date (i.e., post-petition). Any action that is atypical, or out of the ordinary course of business, requires approval of the bankruptcy court. Bankruptcy counsel will assist you in making this distinction. Further, the debtor-in-possession must remain in compliance with certain federal and state statutes that require notice be provided to employees in advance of mass layoffs (i.e., the federal WARN Act and state WARN analogs). It is important to consult restructuring professionals in order to ensure compliance with all applicable law.

## **3. CAN A COMPANY IN CHAPTER 11 ENTER INTO EXECUTIVE EMPLOYMENT AGREEMENTS?**

It depends. While it may be permissible for a debtor to enter into a standard executive employment agreement in the ordinary course of business after filing for bankruptcy protection, it is best practice to obtain court approval, especially if there is anything out of the ordinary course of business about the agreement (which, for example, is likely the case if such agreement is being negotiated post-petition for a senior executive). If the agreement is out of the ordinary course of business, then the debtor company must seek court approval and justify the agreement based on the particular facts and circumstances of the case. Most of the time, the court will apply the so-called “business judgment” standard, which requires that the decision was made on an informed basis, in good faith, and in the honest belief that the decision was made in the best interests of the company, when determining whether to provide such approval.

## **4. CAN A COMPANY IN CHAPTER 11 ENTER INTO AGREEMENTS DESIGNED TO RETAIN KEY EMPLOYEES DURING THE PENDENCY OF THE CHAPTER 11 CASE?**

Companies in bankruptcy are often concerned about retaining key employ-

ees during the reorganization process. The Bankruptcy Code places strict limitations on key employee retention plans (or “KERPS”) to employees who are considered “insiders.” Insiders include officers, directors, and others in control of the debtor company. The Bankruptcy Code prohibits payments or obligations to insiders for the purpose of inducing such person to remain with the debtor’s business, absent an evidentiary finding by the court that:

- (a) It is essential to retain the person because he or she 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 at issue is not greater than 10 times the amount of the mean transfer or obligation of a similar kind given to non-management employees during the calendar year in which the transfer is made or the obligation is incurred, or
  - (ii) If no such similar transfers or obligations were made, the amount of the transfer or obligation may not be 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.

Debtor companies will sometimes structure proposed payments to personnel as key employee incentive programs (or “KEIPS”) in order to avoid the limitations in the Bankruptcy Code. However, as a KEIP is itself outside of the ordinary course of business, it too must be approved by the bankruptcy court. It is important to consult with bankruptcy counsel in order to distinguish between a KEIP and a KERP and to structure any such program in a manner most likely to receive approval by the bankruptcy court.

##### **5. CAN A COMPANY THAT IS CONTEMPLATING FILING FOR CHAPTER 11 ENTER INTO SEVERANCE AGREEMENTS *BEFORE* FILING FOR BANKRUPTCY PROTECTION?**

Again, consult your attorney on this one. You will want the assistance of counsel to weigh your “clawback” risk. When a debtor takes on new contractual obligations on the “eve of” bankruptcy filing, such as those attendant to a severance agreement, those contracts will be closely scrutinized in order to determine whether they can be cancelled so that value can be brought back into the debtor company’s estate. If a company is insolvent at the time it makes a transfer or incurs an obligation, or if the debtor receives less than “reasonably



equivalent value” in exchange for a transfer or obligation, then that transfer or obligation may be subject to clawback and voided. Please note that the length of the clawback period (i.e., the length of the period before bankruptcy, during which time such transactions can be challenged) can vary based on applicable law and the specific circumstances of the transaction at issue.

#### **6. IS A COMPANY IN CHAPTER 11 LIABLE FOR SEVERANCE PAYMENTS PURSUANT TO A SEVERANCE PLAN, POLICY, OR AGREEMENT EXECUTED PRIOR TO THE BANKRUPTCY FILING?**

It depends. If the severance agreement is “executory,” the debtor may seek court approval to reject the severance agreement. Whether an agreement is executory generally is dependent on whether each party to the agreement has material unperformed obligations on the Petition Date. If the debtor company rejects the agreement, then it does not need to continue to perform under the agreement, although the former employee will have a claim for breach of contract against the estate, which will be deemed to have arisen pre-petition and may be subject to a statutory cap under the Bankruptcy Code. If the severance agreement is with an “insider” of the debtor company, then the debtor company may not make such payments unless (a) the payments are part of a program generally available to all full-time employees, and (b) the amount of the payment is no greater than 10 times the amount of the mean severance paid to non-management employees during the year in which the payment is made to the insider.

#### **7. CAN A COMPANY IN CHAPTER 11 RESTRUCTURE DEBTS FOR WAGES AND HEALTH PLAN BENEFITS?**

Yes. A key part of formulating a restructuring plan under Chapter 11 involves consideration of a company’s employee-related debts. Bankruptcy counsel will assist you in formulating a plan that not only makes sense for the future of the company but also is consistent with the provisions of the Bankruptcy Code, applicable law and the company’s business goals. Generally, pre-petition employee claims for wages and benefits, up to a certain amount, are classified as “priority unsecured debt,” provided certain conditions are met. “Priority unsecured debts” are paid *after* secured debts (i.e., debts secured by collateral held by the bankrupt company), but *before* other general unsecured debts (i.e., debts that are not secured by any form of collateral).

This classification applies:

- (1) To forms of compensation such as unpaid hourly wages, salaries, commissions, vacation, severance, and sick leave pay;
- (2) If earned within 180 days of the company’s bankruptcy filing or when the company ceased operating its business, whichever is earlier; and

- (3) Up to \$13,650 per employee who files a claim, with such amount adjusted upward for inflation every three years.

Claims for wages and benefits which were not earned within the time frame or exceed the dollar maximum are treated as general unsecured claims (and, accordingly, do not have priority status). Similarly, employee claims for unpaid contributions to an employee benefit plan (e.g., a pension plan) also are classified as "priority unsecured debt," provided certain conditions are met. Often a motion seeking court permission to pay these pre-petition priority wage and benefit amounts is among the first pleadings a debtor files in a Chapter 11 bankruptcy proceeding and, assuming procedural rules are followed, such motions are routinely allowed.

### **8. CAN A COMPANY IN CHAPTER 11 TERMINATE EMPLOYMENT AGREEMENTS OR COLLECTIVE BARGAINING AGREEMENTS?**

Generally, yes. As previously noted, a debtor company may reject pre-petition agreements if they are "executory." An unexpired employment agreement is an executory contract because both the company and the covered employee have material ongoing obligations under the agreement. Therefore, the debtor company can reject the agreement, and the employee has a claim against the debtor's estate. The Bankruptcy Code gives special treatment to collective bargaining agreements ("CBAs"). In order to reject or modify a CBA, the debtor company must engage in an expedited negotiation process for modifying a CBA, and the court must evaluate whether the debtor can reject a CBA if negotiations are unsuccessful. In order to reject a CBA, the court must determine:

- (1) That the company made a proposal to the union that provides for modifications in the employees' benefits and protections that are necessary to permit reorganization and ensures all affected parties are treated fairly and equitably;
- (2) The authorized representative of the union refused to accept the proposal "without good cause"; and
- (3) The balance of the equities clearly favors rejection of such agreement.

### **9. CAN A COMPANY IN CHAPTER 11 ENFORCE POST-EMPLOYMENT COVENANTS?**

Yes. Companies in bankruptcy can enforce non-competes, non-solicits, non-disclosures and similar post-employment covenants, just as it can outside of bankruptcy, provided that such covenant is valid and enforceable under applicable law.

**10. WHEN A COMPANY FILES FOR BANKRUPTCY, DOES THE AUTOMATIC STAY ENJOIN PENDING EMPLOYEE LITIGATION?**

Yes, generally. The automatic stay enjoins litigation by employees against the debtor company only. The company's bankruptcy filing does not stay any proceedings against individuals who are not themselves in bankruptcy and who may be facing litigation based on their personal liability related to the company. Also, the automatic stay does not enjoin pre-petition claims brought by governmental units (e.g., Equal Employment Opportunity Commission, National Labor Relations Board, Secretary of Labor) to enforce such unit's police or regulatory powers. However, such governmental units generally will be stayed from seeking and enforcing monetary claims.