UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re:

AVIANCA HOLDINGS S.A, *et al.*, Chapter 11

Case No. 20-11133 (MG)

Debtors. (Jointly Administered)

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ORDER GRANTING DEBTORS' MOTION FOR AUTHORITY TO PAY AMOUNTS DUE UNDER THE DEBTORS' LONG TERM INCENTIVE PLAN

This Order addresses the one remaining unresolved issue included in the Debtors' first-day Wages Motion. (ECF Doc. # 3.) The Court has already granted a substantial portion of the Wages Motion, and the Debtors have withdrawn at least for now the request for certain relief that was included in the Motion as to which the United States Trustee ("UST") objected. The remaining issue concerns whether the Debtors may pay 90 employees a total of $359,742 due under the Debtors' Long Term Incentive Plan ("LTIP"). The Debtors have had a long-term incentive plan as a regular part of their executive compensation plans for nine years, so the Court is not dealing with some new plan adopted for, or in anticipation of, their bankruptcy cases, designed to reward favored executives at the expense of other creditors. Indeed, it is noteworthy here that the Creditors Committee supports approval of the disputed LTIP payments.

Under the LTIP the *measurement period* for determining amounts due to LTIP participants extends back more than 180 days prepetition. The measurement period was calendar year 2018. But under the LTIP, the incentive compensation calculated based on the measurement period is "handed over in thirds over the next three years, *provided that the individual continues to work for the company at the time of payment*." LTIP at 8 (emphasis added). What is at issue here is the payment which was due to be made in April 2020 based on the calendar year 2018 measurement period. The petition date was May 10, 2020. The payments to participants for the first of the three payments was made prepetition in April 2019. The issues only arise with respect to the payments for the second of the three payments which were due to be paid in April 2020 but were not paid at that time. For 87 of the 90 employees to whom payments would be made, total proposed payments to those employees would be within the statutory cap under section 507(a)(4) of $13,650. For the three employees where the payments would exceed the statutory cap, the payments to each of those three employees would exceed the cap by approximately $6,000.

The UST objects to payment of these incentive payments because section 507(a)(4) of the Bankruptcy Code only provides a priority for wages up to a statutory cap "earned within 180 days before the date of the filing of the petition." It is undisputed that the measurement period—calendar year 2018—extends back more than 180 days prepetition. If the issue here concerned ordinary wages or commissions, rather than the incentive plan payments, the UST would undoubtedly be on solid ground with its objection, although other legal theories, such as the doctrine of necessity discussed below, might support approval of the disputed payments in any event. As Collier describes and as caselaw supports, the "general rule is that wages, salaries and commissions are earned when the employee obtains a right to payment under the employment contract rather than at the time payment is made. If the employee's right to receive a salary payment is absolute at a particular point in time but payment is deferred until a later date, the salary is earned when the right to receive payment occurred." 4 COLLIER ON BANKRUPTCY ¶ 507.06 (16th ed. 2020). If the right to payment is absolute more than 180 days before the petition date, the compensation is not entitled to a priority under section 507(a)(4). *See, e.g., In* *re Cardinal Indus. Inc.*, 160 B.R. 83 (Bankr. S.D. Ohio 1993). In *In re Cardinal Indus. Inc.*, the court stated that:

> One court has held that "the focal point of 11 U.S.C. § 507(a)(3)[1] is not when the right to [wages] 'matures' but, rather, when it is 'earned'." *Jeannette Corporation v. Gilardi (In re Jeannette Corporation)*, 118 B.R. 327, 329 (Bankr. W.D. Pa. 1990). This analysis recognizes that an otherwise earned commission or bonus may not be mature for payment when "earned" because it may depend on a future contingency for payment. Said differently, the timing of the payment on account of an earned bonus or commission should not be the focus of the analysis under 11 U.S.C. § 507(a)(3)(A). Rather, the focus should be upon the time the individual performed the services which gave rise to the right to the bonus or commission. "Earned" for purposes of priority, therefore, may not always be synonymous with "payable".

Id. at 85. Accordingly, in *Cardinal Indus.*, the court found that the bonus did not satisfy 507(a)(4) because it was "not 'earned' within the [priority period] preceding [the debtor's] bankruptcy petition." (*Id.* at 85–86.)

But the feature of the LTIP that distinguishes it from cases interpreting the phrase "earned within 180 days before the date of the filing of the petition" is the requirement that the participant be employed by Avianca at the times that each of the three payments over a three-year period would be paid. In other words, if the participants are no longer employed by the Debtors on a payment date, they have no right to receive the incentive payment. The incentive payment is unlike amounts due to an employee as wages, commission or a bonus for services already performed; it provides an incentive and rewards an employee who remains with Avianca for at least three more years if the employee is to receive the full amount of the incentive payment. None of the cases relied upon by the UST or found by the Court that reject priority

[1] Redesignated as section 507(a)(4) as part of the 2005 Amendments. *See* PUB. L. NO. 109-8 (2005).

wage claims because of the 180-day time limitation in section 507(a)(4) include similar provisions.

The Court concludes on the specific facts of the Avianca LTIP, that the 180-day limitation in section 507(a)(4) does not apply to the disputed payments under the LTIP. Each payment at issue was to be paid only to Avianca's employee-participants who were still employed by Avianca in April 2020 when the payments were to be made. The payments were truly incentive payments based on a long-established compensation program to reward continued employment of valued employees who are participants in the LTIP. But at least as to three plan participants for whom total compensation payments for the prepetition period would exceed $13,650, the issue remains whether payments to each employee that exceed the cap by approximately $6,000 should be approved. Based on the necessity of payments doctrine, discussed below, the Court concludes that those excess payments—*de minimus* in the context of this case—should likewise be approved.

The Debtors also argue a second basis for the Court to approve the disputed LTIP payments even if the payments would not be provided with priority treatment under section 507(a)(4)—namely, that the doctrine of necessity supports Court approval of these payments. The Court is generally wary of applying the doctrine of necessity to approve payments not otherwise permitted by the Bankruptcy Code. But here, in fact, there are strong grounds for approving the LTIP payments under the doctrine of necessity. The Debtors' counsel argues, supported by a declaration of Colombian counsel and not disputed by the UST, that under the law of Colombia, where the Debtors are headquartered and most employees work, the LTIP payments are given a higher priority in an insolvency proceeding and are required to be paid in full. If not paid, the Debtors may be subject to severe legal consequences. This argument will be discussed further below.

In support of their argument that the LTIP payments should be approved, the Debtors' counsel points to other bankruptcy courts that have approved payments that were not otherwise entitled to priority under section 507(a)(4). *See, e.g.*, *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (Bankr. E.D. Va. Mar. 13, 2020) [Docket No. 348] (approving payment of prepetition employee compensation obligations in excess of section 507(a)(4) priority cap over objection of United States Trustee, subject to a $250,000 aggregate cap); *In re Gibson Brands, Inc.*, Case No. 18-11025 (Bankr. D. Del. July 12, 2018) [Docket No. 431] (approving payment of prepetition employee compensation obligations in excess of section 507(a)(4) priority cap over objection of official committee of unsecured creditors, and noting at the hearing that "[t]he doctrine of necessity doesn't rely on the provisions of Section 507 of the Code", and that "employee morale is more of a concern in this instance than the dollars"), Hr'g Tr. 20:7-22:16 [Docket No. 428]; *In re THQ Inc.*, Case No. 12-13398 (Bankr. D. Del. Jan. 11, 2013) [Docket No. 144] (approving payment of prepetition employee compensation obligations in excess of section 507(a)(4) priority cap over objection of official committee of unsecured creditors and ad hoc committee of noteholders).

The Debtors argue that a bankruptcy court may authorize payment of prepetition claims in appropriate circumstances based on section 105(a) of the Bankruptcy Code. Specifically, courts have the power under section 105(a) of the Bankruptcy Code to authorize payment of prepetition obligations pursuant to the "necessity of payment" rule (also referred to as the "doctrine of necessity"). *In re Ionosphere Clubs*, 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989).

Debtors' counsel argues, supported by the declaration of Colombian counsel, that local labor laws in the various jurisdictions in which the Debtors operate require the payment of the LTIP obligations. The Colombian Constitutional Court, for example, has granted constitutional protection to obligations due to employees for salaries, benefits, and pensions, and such obligations are granted first priority in any Colombian insolvency proceeding. The recognition and payment of these kind of claims is generally considered a fundamental constitutional right as it relates to articles 11 (Right to Life), 49 (Health), 25 (Work), 48 (Social Security), and 53 (Payment of Wages) of the Colombian Constitution.[2]

The failure to pay labor claims in Colombia, including the LTIP obligations, may result in the commencement of litigation against the Debtors in Colombia. Since many of the potential employee litigants have few if any contacts with the United States, the automatic stay under the Bankruptcy Code may not be enforceable against such litigants in Colombia. Thus, the Debtors and their management team may need to devote substantial time and resources to adjudicating these claims, which may result in sizable damages claims against the Debtors. In addition to ordinary litigation claims, the failure to pay labor claims could result in a "tutela" action against the Debtors, which is an appeal for immediate relief that allows Colombian citizens to make claims to their constitutionally protected fundamental rights without need for a lawyer and must be responded to by a Colombian judge within 10 days. *See generally*, Whitney K. Taylor, AMBIVALENT LEGAL MOBILIZATION: PERCEPTIONS OF JUSTICE AND THE USE OF THE TUTELA IN COLUMBIA, 52 Law & Soc'y Rev. 337 (June 2018). For such actions, the Debtors may not be

[2] The Court believes there is an open issue whether choice of law principles should be applied in determining the insolvency priority applicable to employee wage claims for employees who work outside the U.S. This could lead to the application of Colombian or other non-U.S. law to the priority to be accorded to the LTIP claims. Because the Court concludes that the payments should be authorized under the doctrine of necessity, the Court finds it unnecessary to resolve the choice of law issue.

able to enforce the automatic stay to protect the estates and their property from the exercise of remedies by such claimants.

Failure to satisfy the obligations due under the LTIP also may subject the Debtors to regulatory or administrative penalties assessed by the Colombian Ministry of Labor. Debtors' counsel asserts that such penalties could approximate up to COP $4.5 billion (approximately USD $1.24 million).

Further, any failure to pay the LTIP obligations also may impede the Debtors' reorganization efforts. To the extent the Debtors decide to seek local recognition of their chapter 11 plan in Colombia, the risk of a Colombian court denying recognition of the chapter 11 plan would be significantly increased if it does not provide for the payment of all valid employee claims. Under Colombian law, the labor claims have priority over all other claims, whether secured or unsecured. Any recovery to secured creditors is possible only if labor credits have been paid in full, or if the debtor can prove that other assets of the estate are sufficient to satisfy outstanding labor claims. Thus, to the extent that the LTIP obligations remain unpaid, local recognition of the Debtors' chapter 11 plan may not be a viable option for the Debtors.

The Debtors cite *In re LATAM Airlines Group S.A.*, a case pending before Judge Garrity on this Court, which recently considered this overlay of local labor laws in the context of a similar section 507(a)(4) objection by the UST. Judge Garrity overruled the UST objection, expressing similar concern whether the refusal to authorize payment of similar employee wage claims could create problems for the LATAM debtors in each of the local jurisdictions with laws establishing priority schemes for employee wages different from the priorities in the Bankruptcy Code. Judge Garrity explained that "[t]he automatic stay might not protect them . . . [as] there would be a local enforcement with respect to the amounts due and owing." Hr'g Tr. 86:14-23, *In* *re LATAM Airlines Group S.A.*, Case No. 20-11254 (Bankr. S.D.N.Y. June 23, 2020) (JLG). The Court agrees with Judge Garrity's reasoning. The non-payment of the unpaid LTIP obligations could result in serious adverse consequences for the Debtors in terms of employee morale, which the Debtors need to maintain if they are successfully going to reorganize. Non-payment would be inconsistent with multiple local labor laws and could result in the commencement of various proceedings against the Debtors for which they may not be able to avail themselves of the protections afforded by the automatic stay. For these reasons, the Court concludes that the doctrine of necessity supports approval of the disputed LTIP payments even if, contrary to the Court's earlier conclusion, the payments would otherwise fall outside the priority period of section 507(a)(4). And the doctrine of necessity supports approval of the payments to three employees to whom payments will exceed the statutory cap.

While this Order grants the Debtors' Motion to authorize payments under the LTIP, before making the disputed payments, the Debtors' counsel should settle a separate order including a schedule (which may be filed under seal) identifying the name of each participant and the amount each participant will receive under the LTIP.

IT IS SO ORDERED.

Dated: July 15, 2020
New York, New York

s/ **Martin Glenn**
Martin Glenn
United States Bankruptcy Judge