

When is a Bonus a Fraud?

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We use the term “Fraudulent Conveyances” to describe transfers by an insolvent Debtor for which it did not receive in return something of reasonably equivalent value.

For Bankruptcy Trustees and their counsel, preparations to celebrate are underway: In just two years we will observe the 450th birthday anniversary of the Statute of Elizabeth which enshrined this concept in English Law.

Earlier this month, a Court in Delaware reminded us of the limitations placed upon Trustees when seeking to unwind transfers and recover assets for the benefit of all creditors under the concept of Fraudulent Conveyances. See *In re: F-Squared Investment Mgmt., LLC*, Case No. 15-11469 (LSS) (Bankr. D. Del. May 7, 2019).

In *F Squared Investment*, the Trustee of a liquidation trust sued four individuals engaged by the Debtor who were paid bonuses while the Debtor was insolvent. The bonuses were paid pursuant to language in their engagement agreements and the Debtor’s employee handbook which provided for the possibility of bonuses paid by the Debtor completely at the Debtor’s discretion and without the need for any specific goals or measurable, quantifiable benchmarks or performance standards to be achieved.

The Trustee’s argument was straightforward: when Debtor paid the bonuses to its employees the Debtor was insolvent, was not paying its creditors, and was not obligated to pay the bonuses. Therefore, the bonus payments constituted fraudulent conveyances, which should be recovered and added to the pot of money available to pay creditors (and estate administrative expenses).

The Court adopted the defendants’ argument that payment of these bonuses was not per se a fraud upon creditors. The Court accepted the argument that there could be value to the Debtor’s business as a result of paying these discretionary bonuses, even though it was not required, and no measurable standards were employed in making the award.

On one hand, the trustee’s position, that paying discretionary bonuses while leaving some creditors unpaid was unfair and fraudulent, seems reasonable. However, the Court opined that there may be value to the business in rewarding outstanding performance even in the absence of metrics. The Court determined that the finding of even a slight chance that a benefit might be conferred upon a debtor is sufficient to show that some value has been conferred. Moreover, the Court stressed that the determination of whether value has been received by the

debtor is an inherently factual determination to be made on a case-by-case basis looking into the circumstances of the specific transaction at the time it occurred.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of employment law, please contact Michael Traison at [312.860.4230](tel:312.860.4230)

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