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3rd Circ. Sheds Light On Insider Status In Bankruptcy

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Insider status in U.S. bankruptcy carries with it significant burdens. Insiders face a one-year preference exposure rather than the 90-day period applicable to noninsiders, insiders are by definition disinterested persons and may not be retained to provide professional services and transactions among debtors, and insiders are subject to heightened scrutiny under the entire fairness doctrine.

From a reorganization perspective, however, the issue could impair the ability of debtors to retain critical personnel. Debtors often wish to retain certain employees whom they consider valuable to their reorganization. Section 503(c) of the Bankruptcy Code, however, prohibits, subject to certain conditions, payment of "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 debtor's business."[1] Courts have noted that the requirements of 503(c) are almost impossible to meet.[2] Thus, whether a debtor can make such payments to an employee will often hinge on whether the employee is considered an "insider."

The Bankruptcy Code defines an insider of a corporation to include, among others, officers of the debtor.[3] While some of these categories are straightforward, i.e. directors, courts have grappled with what it means to be an officer of a debtor. A recent nonbankruptcy Third Circuit decision, Aleynikov v. Goldman Sachs Group Inc.,[4] may shed light on this issue.

Prior Case Law in the Third Circuit Addressing "Insider" Status of Officers

The 2009 Delaware decision In re Foothills Texas[5] involved a situation in which the debtor corporation had filed a motion to pay retention bonuses to certain of its employees, including two employees with the title of "vice president." The United States trustee objected, arguing that the payments should not

be authorized because the vice presidents were officers and therefore insiders who could not receive retention payments under Section 503(c).

In analyzing the issue, the court looked to dictionary definitions of vice president and of officer and noted that a vice president fell within the plain meaning of the term officer. The court also noted, however, that there could be situations in which a person fell within the plain meaning of officer but did not actually meet the definition. Therefore, the court created a rebuttable presumption that a vice president was an officer.

The presumption may be overcome with sufficient evidence showing that the employee was "in fact, not participating in the management of the debtor."[6] The evidence established that the employees at hand did not play a role in making operational, tactical or strategic decisions and that one of them did not supervise any employees while the other supervised four. Nonetheless the court held the employees to qualify as insiders since they were "in charge of important aspects of the Debtors' business," i.e. one oversaw the debtors' oil and gas leases and the other oversaw oil and gas production and development.

An earlier Delaware case in a slightly different bankruptcy context also held that courts should respect the plain meaning of "officer." In In re Essential Therapeutics Inc.[7] the bankruptcy court was faced with an objection to the retention of counsel for the debtor on the basis that one of the attorneys had previously served as an officer to the debtor.[8] The attorney had served as a secretary of the debtor, which was included in the definition of officer in the debtor's bylaws.

Counsel argued that the attorney should not truly be considered an officer because his tasks as secretary to the company were ministerial and did not involve management decisions. The court rejected this argument and stated that there was no room for inquiry into an employee's role when the plain language of the bylaws established that he was an officer.

The Aleynikov Decision

In Aleynikov, the Third Circuit addressed the issue of how to define "officer" and considered whether a vice president can qualify as an officer in the context of one's right to seek indemnification and advancement of legal fees from their employer. Appellee Sergey Aleynikov had held the title of vice president at Goldman Sachs & Co. (GSCo) and later sought indemnification and advancement of legal fees for defense costs related to a criminal proceeding against him, pursuant to a section of GSCo's bylaws that provided indemnification and advancement for officers of the company.

GSCo argued that, as a vice president, Aleynikov was not an "officer" entitled to indemnification and advancement. The evidence established that GSCo employs tens of thousands of employees, about a third holding a title of vice president. Aleynikov did not supervise other employees and exercised no management or leadership responsibilities. In line with Foothills Texas, the District Court for the District of New Jersey held that vice president unambiguously fell within the definition of officer and awarded summary judgment to Aleynikov on his claim for advancement.[9]

On appeal, the Third Circuit vacated the district court's grant of summary judgment and remanded for further proceedings to determine whether Aleynikov was an officer of GSCo. The Third Circuit analyzed GSCo's bylaws, which did not include vice presidents within the defined term, and determined that the definition of officer contained therein was ambiguous.

In turn the court also looked to dictionary definitions and to industry practices. Dictionary definitions were held ambiguous as well since they indicate that an officer is a person "holding a position of trust, authority, or command" while only one source required the officer to be appointed or elected. As to industry practice, the court noted that if there was "a readily identifiable, industry-specific common meaning of the term," that could have turned it unambiguous, but no such evidence was presented to the court.

Therefore, the court turned to extrinsic evidence to determine whether Aleynikov qualified as an officer of GSCo. While the court stated that some extrinsic evidence would be irrelevant and not indicative of intent because the bylaws were drafted unilaterally, it considered "course of dealing" and "trade usage" evidence to be probative. To that end, it considered the procedures for appointing and removing officers at GSCo, GSCo's past indemnification practices, and evidence from news articles that vice president was an exceedingly common title in the financial services industry.

Consideration of the extrinsic evidence led the court to its conclusion that there was a genuine issue of material fact as to whether Aleynikov, as vice president of GSCo, was an officer entitled to indemnification. Specifically, GSCo had a smaller subset of officers that did not include vice presidents and that were subject to appointment and removal procedures and were required to be named in public regulatory filings, suggesting that the same group of officers may be the employees who were intended to be entitled to defense costs.

Additionally, GSCo did not have a practice of indemnifying vice presidents, which made sense in light of the evidence of how common it was for an individual to have the vice president title in GSCo's industry. In light of this information, the court held that additional evidence would be needed in order to permit a fact finder to determine whether Aleynikov was an officer.

Implications

While Aleynikov was not decided in the context of bankruptcy, it would appear that the presumption established by the Foothills Texas case, may no longer be followed. The title, vice president, in and of itself, should not be viewed as conferring officer, and thus insider, status, ipse dixit. The harder question involves the application of the Aleynikov case in situations where a debtor's bylaws define "officers" to include vice presidents (or any other title for that matter).[10] While not directly on point, it appears that the Third Circuit tends to infuse the term with substance, rather than rely on a formulaic approach.

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[1] 11 U.S.C. § 503(c) (emphasis added).

[2] See, e.g., In re Foothills Texas Inc., 408 B.R. 573, 577 (Bankr. D. Del. 2009) ("The requirement in Section 503(c)(1)(A) that payments may only be made to insiders that have a 'bona fide job offer from another business at the same or greater rate of compensation' has proven virtually impossible for debtors to meet.")

[3] See 11 U.S.C. §101(31).

[4] 2014 WL 4347187 (3d Cir. Sept. 3, 2014).

[5] 408 B.R. 573 (Bankr. D. Del. 2009)

[6] Id. at 579.

[7] 295 B.R. 203 (Bankr. D. Del. 2003).

[8] The Bankruptcy Code prohibits retention of counsel who has previously served as an officer of the debtor in the two years prior to the filing date. See 11 U.S.C. §§ 101(14), 327(a).

[9] The district court denied summary judgment on Aleynikov's indemnification claim pending further discovery on the monetary amounts due. See Aleynikov v. Goldman Sachs Grp. Inc., 2013 WL 5739137 at *3 (D.N.J. Oct. 22, 2013).

[10] One distinction between Foothills Texas and Essential Therapeutics is that Foothills Texas did not expressly consider the debtor's bylaws or look to a contract for a definition of officer, while in Essential Therapeutics, the debtor's bylaws defined the term officer to include a secretary of the corporation.
