

GAO@100 Highlights

Highlights of [GAO-21-104617](#), a report to congressional committees

Why GAO Did This Study

In response to potential abuses involving executive bonuses, Congress amended the Code in 2005 to restrict debtors in Chapter 11 from paying executives retention bonuses for staying through bankruptcy and, to a lesser extent, incentive bonuses to achieve performance targets. Recently, some large companies have paid their executives considerable bonuses during bankruptcy. House Report 116-455 included a provision for GAO to review Code provisions on bonuses and a selected number and amount of court-requested and approved bonuses in fiscal year 2020.

This report reviews (1) Bankruptcy Code provisions on employee bonuses, (2) selected stakeholder views on such provisions, and (3) employee bonuses awarded by companies before or after filing for bankruptcy in fiscal year 2020. GAO reviewed the Code, academic literature, and legal analyses; interviewed 12 academics, attorneys, and an organization selected for their bankruptcy expertise; and analyzed bankruptcy filings and related data using Westlaw Edge and other sources.

What GAO Recommends

Congress should consider amending the Bankruptcy Code to clearly subject bonuses debtors pay executives shortly before a bankruptcy filing to bankruptcy court oversight and to specify factors courts should consider to approve such bonuses.

View [GAO-21-104617](#). For more information, contact Michael E. Clements at (202) 512-8678 or clementsm@gao.gov

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BANKRUPTCY

Enhanced Authority Could Strengthen Oversight of Executive Bonuses Awarded before a Bankruptcy Filing

What GAO Found

Chapter 11 bankruptcy allows a company (debtor) to restructure its debt—so that it may continue to operate—and generally retain its executives. Section 503(c) of the Bankruptcy Code (Code) restricts retention bonuses for executives and, to a lesser extent, executive and non-executive incentive bonuses during bankruptcy. For instance, to pay an executive a retention bonus, the Code requires the debtor to meet three requirements, including that the executive has another job offer at the same or greater compensation. Also, debtors must obtain court approval to pay employee bonuses during bankruptcy—a process that gives creditors an opportunity to raise objections. However, the Code generally does not govern executive retention bonuses paid before a bankruptcy filing (pre-bankruptcy bonuses).

Academics and attorneys GAO interviewed largely viewed Section 503(c) as less-than-effective because debtors can work around its restrictions on executive retention bonuses both before and during bankruptcy. For example, debtors can pay retention bonuses before filing (when there are generally no restrictions), or they can pay incentive bonuses during bankruptcy (that have fewer restrictions). Some stakeholders viewed Section 503(c) as overly restrictive, but others viewed it as helping to prevent abusive bonuses. Nearly all stakeholders GAO interviewed viewed pre-bankruptcy bonuses as problematic. For example, they said that these bonuses reduce the debtor estate's value for creditors but are awarded without notice to creditors or court approval.

Based on court dockets for the approximately 7,300 companies that filed for Chapter 11 bankruptcy in fiscal year 2020, GAO found the following:

- Less than 1 percent (70) of debtors requested court approval to pay employee bonuses, and the courts approved nearly all the requests.
- Debtors awarded around \$571 million to more than 16,600 executive and non-executive employees through court-approved bonuses.
- Creditors or U.S. Trustees (who administer and monitor Chapter 11 cases) raised objections in 50 percent of all bonus requests, including 68 percent of executive incentive bonus requests, which frequently led debtors to modify their plans (for example, by lowering bonus amounts).
- None of the debtors requested court approval for executive retention bonuses during bankruptcy; 42 debtors awarded pre-bankruptcy retention bonuses—totaling about \$165 million—from 5 months to 2 days before filing.

According to some attorneys GAO interviewed, Section 503(c) makes it nearly impossible to award executives retention bonuses during bankruptcy, so debtors use pre-bankruptcy bonuses as a workaround. As noted above, GAO found that none of the 7,300 Chapter 11 debtors that filed in fiscal year 2020 requested executive retention bonuses during bankruptcy but 42 awarded such bonuses shortly before filing. This practice may undermine Section 503(c)'s restrictions and decrease the ability of creditors, U.S. Trustees, and the courts to prevent bonuses that are inconsistent with the section's requirements.