

# Get to the Back of the Line

*Delaware bankruptcy court holds C-Suite stock comp is equity security*

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Recently, in *GSE Environmental, Inc. v. Sorrentino* (In re GSE Environmental, Inc.), on a motion for judgment on the pleadings, the Bankruptcy Court for the District of Delaware held that the Chief Executive Officer's claim for unpaid compensation payable in stock constituted an equity security rather than a general unsecured claim. The facts of GSE Environmental are an all too familiar story in the bankruptcy context: Company files for chapter 11, but certain employees, or in this case executives, were not paid their full compensation before the petition date. Whether such unpaid compensation is treated as a general unsecured claim or equity securities can have a tangible effect on the employee's recovery in the case. GSE Environmental serves as one example of a variation of unpaid compensation that may be treated as an equity security.

## **Background**

Charles Sorrentino served as interim president and CEO to the debtors, GSE Environmental, Inc. and GSE Holding, Inc., as of July 1, 2013. Pursuant to his original employment agreement, Sorrentino was earning \$186,000 per month payable in cash. A month later, the parties amended his agreement to provide that \$100,000 of Sorrentino's monthly compensation would be payable in cash and the balance in company stock. Nearly a year later, the debtors filed for chapter 11. As of the petition date, Sorrentino's equity compensation remained unpaid and he filed a proof of claim in the amount of approximately \$260,000 on account thereof.

On March 18, 2016, the debtors filed a complaint seeking a declaration that Sorrentino's claim was not a general unsecured claim, or in the alternative, that it should be subordinated under section 510(b). After the parties briefed the matter, the debtors filed a motion for judgment on the pleadings.

## **The Share-Based Component of CEO's Compensation Constituted an Equity Security**

The court began its analysis with the definition of equity security, which includes "warrants or rights . . . to purchase, sell . . . a share, security, or interest" in a corporation. 11 U.S.C. § 101(16)(A), (C).

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Then the court went on to cite several Delaware cases, which have held that common stock received in exchange for labor constitutes an equity security. Sorrentino contended that the value of the stock owed to him was

denominated in dollars rather than in a fixed number of shares and, thus, was not an equity security. Judge Walrath, not convinced by this argument, explained that although the quantity of stock owed to Sorrentino was based on a dollar amount, the agreement only entitled him to stock, not cash. Accordingly, and because Delaware case law recognizes that stock exchanged for labor constitutes an equity security, the court granted the debtors' motion holding that the CEO's claim was actually an equity security rather than a general unsecured claim.

## **Conclusion**

Some may look at GSE Environmental and think "If it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck." But, it is not always that straightforward. GSE Environmental reminds that there may be nuances in compensation structures that may dictate whether unpaid compensation should be classified as a general unsecured claim or an equity security and, consequently, may dictate the fate of the employee's ultimate recovery in the case.



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