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Managing Management and Employment/Labor Issues in Bankruptcy

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U.S. Bankruptcy Court (E.D.N.Y.)

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In re BIDERMANN INDUS. U.S.A.

United States Bankruptcy Court for the Southern District of New York

January 6, 1997, Decided ; January 7, 1997, DOCKETED

Chapter 11, Case Nos. 95 B 43098 through 43099 (TLB) and 95 43101 through 43114 (TLB) (Jointly Administered)

Reporter
203 B.R. 547 *; 1997 Bankr. LEXIS 10 **

In re BIDERMANN INDUSTRIES U.S.A., INC., f/a./a BLACKSTONE, INC., et al., Debtors.

Core Terms

fiduciary, letter agreement, offers, note holder, purchasers, bidding, chief executive officer, due diligence, negotiated, memorandum of understanding, approve, unsecured creditor, obligations, leveraged, bidders, buyout, salary, window, stock, shop, rule rule rule, reorganization, confirmation, shareholder, businesses, themselves, acquire, parties, reimbursement, self-dealing

Case Summary

Procedural Posture
Petitioner debtors sought court approval of a letter agreement, which would promulgate an anticipated leverage buyout of the debtors by a partnership and the debtors' turnaround consultant.

Overview
Prior to filing their bankruptcy petition, the debtors retained turnaround consultants. With the inception of their bankruptcy cases, a principal of the turnaround consultant firm was retained as chief executive officer (CEO) of the debtors in possession. Under the letter agreement, the turnaround consultant firm would have had a minority equity position to the partnership and the CEO of the debtors' interests would serve as the chief executive officer and chairman of the board of the new owner. Objectors to the letter agreement asserted that the CEO had abandoned the debtors' interests to advance his own personal wealth but a committee of unsecured creditors supported the motion. The court held that the relationship of the parties who negotiated the break-up fee was tainted by self-dealing because the CEO had a fiduciary duty to support the debtors' best interests, the proposed fee hampered rather than encouraged bidding because no third party purchasers were sought, and the amount of the fee was unreasonable relative to the proposed purchase price because the fees did not bear a reasonable relationship to the bidders' efforts.

Outcome
The debtors' motion for approval of the letter agreement was denied.

LexisNexis® Headnotes

Bankruptcy Law > Procedural Matters > Professional Responsibility

HN1[] Procedural Matters, Professional Responsibility

Three questions need be considered by a court when it assesses proposals for breakup fees: (1) is the relationship of the parties who negotiated the break-up fee tainted by self-dealing or manipulation; (2) does the fee hamper, rather than encourage, bidding; and (3) is the amount of the fee unreasonable relative to the proposed purchase price?

Counsel: [1]** APPEARANCES:

Co-counsel for Debtors in Possession: STEVENS & LEE, P.C., By: Robert Lapowsky, Esq., Wayne, Pennsylvania. MARKS & MURASE L.L.P., By: Michael Z. Brownstein, Esq., New York, New York.

Counsel for the Official Committee of Unsecured Creditors: OTTERBOURG, STEINDLER, HOUSTON & ROSEN, P.C., By: Scott L. Hazen, Esq., New York, New York.

Counsel for the Objectants: KASOWITZ, BENSON, TORRES & FRIEDMAN L.L.P., By: David M. Friedman, Esq., New York, New York.

Judges: Tina L. Brozman, CHIEF UNITED STATES BANKRUPTCY JUDGE

Opinion by: Tina L. Brozman

Opinion

[*549] CORRECTED TEXT OF BENCH RULING ISSUED DECEMBER 17, 1996

TINA L. BROZMAN, Chief United States Bankruptcy Judge

Thirty years ago Judge Henry Friendly, sitting on the Second Circuit Court of Appeals, declared that the conduct of bankruptcy proceedings not only should be right but must seem right. *Knapp v. Seligson (In re Ira Haupt & Co.), 361 F.2d 164, 168 (2d Cir. 1966)*. In this case, the fiduciaries must have blinded themselves to Judge Friendly's counsel.

Bidermann Industries U.S.A., Inc. and certain of its subsidiaries filed chapter 11 petitions on July 17, 1995. Prior to their bankruptcy, they retained Alvarez & Marsal **[**2]** ("A&M") as turnaround consultants. With the inception of their bankruptcy cases, Mr. Marsal was retained as chief executive officer of the debtors in possession at a salary of $ 700,000 per year. Carter Evans of that firm was also retained by the debtors at a salary of $ 350,000 per year. In addition, the debtors were authorized to utilize the services of various A&M personnel. This whole arrangement received court approval. To date, the fee requests for the additional A&M personnel have run at about $ 100,000 to $ 200,000 for each four months.

The debtors in possession ask me to approve a letter agreement which will put into motion an anticipated leveraged buyout of the debtors by Vestar Equity Partners, L.P. ("Vestar") and A&M. Not only will A&M have a minority equity position, financed in part by a success fee which Vestar will pay to them for selling the businesses to themselves, but Bryan Marsal of that firm, who remains as the debtors' chief executive officer, will be the chief executive officer and chairman of the board of the new owner ("Newco") pursuant to an employment agreement which will be for a term of at least three years. Indeed, Mr. Marsal's retention is a condition **[**3]** precedent to the consummation of a chapter 11 plan which will embody the parties' agreement.

That agreement is memorialized in a memorandum of understanding to which the letter agreement is a collateral document. Although the motion as submitted requested that I approve the memorandum of understanding, that request has been withdrawn and my approval is sought at this time only for the letter agreement. However, an understanding of the proposed transaction is critical to the decision whether or not to approve the letter agreement.

Pursuant to the memorandum of understanding, Vestar, if it is satisfied with the results of its due diligence (which is well underway) and a number of other things, will invest probably $ 40 million and up to a maximum of $ 60 million based on a formula contained in the memorandum. The amount of this equity contribution is in the sole discretion of Vestar and A&M. There will also be $ 5 million to $ 6 million contributed by management and A&M as well as a $ 32.5 million equity contribution, or such other number as is satisfactory to Vestar and A&M, by one or more investors satisfactory to Vestar and A&M. Certain of the debtors' lenders will invest some $ **[**4]** 12 million. The balance of the stated $ 233 million value of the transaction will be raised by a combination of methods all relying upon the intrinsic value of the debtors' own assets, a classic leveraged buyout. The principal negotiation as to the $ 233 million value occurred between Vestar and one creditor, Merrill Lynch, which is one of the five institutional note holders. Merrill Lynch is not a fiduciary to the creditors. In fact, if the proposed transaction ultimately is approved as part of a plan of reorganization, Merrill Lynch will be paid fees of $ 3 million for underwriting the high yield debt offering of one of the debtors. As can be seen from these facts, the value of the equity contribution cannot be calculated with finality, couched as it is in the discretion of the would-be purchasers. In theory at least, the equity contribution could be minimal if the value obtained by leveraging the debtors' assets is sufficient to make most of the payments called for under the proposed plan of reorganization whose terms are dictated in the memorandum of understanding.

Just as there are provisions in the memorandum of understanding which are favorable to Bryan Marsal and his firm, **[**5]** there are provisions favorable to Maurice Bidermann, **[*550]** the debtors' majority shareholder, whose cooperation was thereby ensured. Specifically, Mr. Bidermann will be given a 10-year option to acquire two percent of the common stock of Newco at a price equal to the price per share paid by Vestar. He will also be given an option to purchase for $ 5 million common stock of Newco and 13% junior preferred stock up to 15 days prior to the first date set for the confirmation hearing on the debtors' plan. Yet another option given to Mr. Bidermann will be the right to purchase up to 15 days prior to the first scheduled confirmation hearing either 20%, for $ 11 million, or 10%, for $ 5.5 million, of the common stock of the entity which will own the Arrow trademark and the rights as licensor under various Arrow licenses. He will receive a right of first refusal for a period of 180 days following the effective date of the plan in connection with any sale of stock in Cluett International, Inc., one of the emerging entities. He will receive a consulting agreement paying him $ 300,000 annually for five years and $ 750,000 on the effective date for his agreement not to compete. And not least, he will **[**6]** receive a release from, among other parties, the debtors. Needless to say, perhaps, these incentives have not been offered to the debtors' minority shareholders.

There are numerous conditions to confirmation of a plan, some of which are that Vestar satisfactorily completes its due diligence, that various documents are drafted to the satisfaction of, among other persons, Vestar and A&M, and that there is a resolution of certain matters with the debtors' union to the satisfaction of Vestar and A&M, among others. Consummation of a plan is conditioned on other things, including the raising of the non-equity capital. In other words, Vestar is not inescapably committed to proceed.

Notwithstanding the imprecision in the value of the equity contribution and the opportunities for Vestar to back out of the purchase, the debtors wish to be bound to Vestar in a number of respects which are laid out in the letter agreement which I am asked to approve. Specifically, in what is styled as an inducement to Vestar to undertake due diligence, the letter agreement provides:

1. for an expense reimbursement of up to $ 2 million;

2. for a topping fee of $ 2 million, or, if the consideration **[**7]** to the debtors in whatever form exceeds $ 233 million, the lesser of 10% of the consideration over $ 233 million or $ 3.8 million;

3. for a broad indemnification of Vestar;

4. that the debtors will not solicit, initiate or encourage the submission of any inquiries, proposals or offers from other potential bidders and will not furnish any such persons with any information which might lead to a competing inquiry, proposal or offer, except that the debtors shall allow the proponent of a competing offer containing a superior purchase price to conduct due diligence. Notwithstanding the bar on their encouragement of better offers, the debtors may take any of the prohibited actions if the failure to do so would violate their fiduciary duties;

5. that the debtors will not file a plan which is inconsistent with the memorandum of understanding; and, finally,

6. for the provision of an administrative expense obligation to Vestar for the previously-mentioned obligations of the debtors.

Whether Vestar needs any further inducement is open to serious doubt, since it has conducted much of the due diligence already and has locked up the cooperation of all the debtors' fiduciaries.

[8]** Two of the debtors' institutional note holders (which also hold secured claims) object to my approval of the letter agreement, pointing out that Mr. Marsal has abandoned the debtors' interests in order to advance his own personal wealth. Inexplicably, they say, when the debtors decided to sell themselves, they committed to a transaction with Mr. Marsal without retaining an investment banker or even testing the waters to see if a more favorable arrangement were available. Indeed, the objectants note that the debtors have not responded to the one solicitation which they received in September from a well-heeled investment firm, an assertion which Mr. Marsal confirmed. Instead of responding to the inquiry from that investment firm, Mr. Marsal told Vestar of the letter--and, as Vestar's managing director testified, **[*551]** he informed the investment firm that Vestar was well along in its negotiations with the debtors, a patent attempt to discourage further interest. The objectants also argue that the bidding procedures and attendant fees are a disincentive to attainment of the best possible price for the debtors. The committee of unsecured creditors supports the motion, as do at least two of the **[**9]** five institutional note holders and the debtors' union.

Discussion

The fiduciary obligations of directors pervade bankruptcy administration. *Ross v. Kirschenbaum (In re Beck Industries, Inc.), 605 F.2d 624, 634 (2d Cir. 1979)*. And the actions of the chief executive officer of the company are imbued with fiduciary obligations as well. *Id. at 634-35*. Some years ago I was faced with a dispute following a sale to the debtor's chief executive officer. Evidence had been presented that the insider had not revealed the existence or extent of certain assets which he had purchased from the debtors. *C & J Clark America, Inc. v. Carol Ruth, Inc. (In re Wingspread Corporation)*, 92 Bankr. 87 (Bankr. S.D.N.Y. 1988). As I explained there, sales to fiduciaries in chapter 11 cases are not *per se* prohibited, "but [they] are necessarily subjected to heightened scrutiny because they are rife with the possibility of abuse." *Id. at 93*. Plainly, such careful inquiry is mandated here. Not only is Mr. Marsal a fiduciary by virtue of his position as chief executive officer, but he was hired by the debtors in possession (at a salary of $ 700,000 per year for himself and $ 350,000 **[**10]** for one of his colleagues) for his professional expertise in running troubled companies. By virtue of this latter role, he was placed in a position of trust and confidence so that, if there be any consequence at all, it is that his actions ought be subjected to a scrutiny even higher than that usually accorded the debtor's management.

That Mr. Marsal has a conflict of interest almost goes without saying. On the one hand he was hired to enhance the value of the debtors' businesses; the decision being made by the debtors to offer themselves for sale, it became his obligation to help ensure that the debtors received the highest and best offer available. *Cf.* Beck Industries, 605 F.2d at 635 (court noting that the president of subsidiary to be sold was relieved from the usual obligation to obtain competing purchasers who would bid up the price to his disadvantage because his court- approved employment agreement gave him a right of first refusal). On the other hand, by virtue of his role as an equity participant, Mr. Marsal either was, or has to have been perceived as being, motivated to secure for himself and Vestar the lowest sale price reasonably attainable. Yet it was Mr. Marsal **[**11]** who determined the course that the debtors' reorganization was to take. He determined to break off negotiations on a "stand-alone" plan of reorganization and he decided to proceed with Vestar.

It is astounding that the debtors have not hired an investment banker to test the marketplace for other expressions of interest. That they had an investment banker two years ago, prior to the bankruptcy and before the businesses underwent the surgical knife and suturing of chapter 11, is really of no moment. As Mr. Marsal testified, they are a different enterprise today. How the debtors could have determined to proceed with this offer without knowing what else may be available defies any explanation other than that Mr. Marsal had made up his mind and held Mr. Bidermann in his sway with lucrative incentives. The debtors have not even bothered to offer any reason why a management-sponsored leveraged buyout is in their best interests. Mr. Marsal testified that the debtors could reorganize absent the Vestar/A&M transaction. Viewed as a whole, the proposed sale does not reveal the effective exercise of business judgment, but rather the "illicit manipulation of a board's deliberative process by self- **[**12]** interested corporate fiduciaries." *Official Committee v. Integrated Resources, Inc., (In re Integrated Resources, Inc.)*, 147 Bankr. 650, 658 (S.D.N.Y. 1992), appeal dismissed, 3 F.3d 49 (2d Cir. 1993) (quoting Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988)).

If the overall concept is questionable, then the bidding procedures are nothing short of incomprehensible. How could the debtors possibly agree not to encourage other **[*552]** offers in the face of an insider sale where a large part of A&M's equity contribution is to come from a success fee (if approved by the court) paid to the firm by one of the purchasers? Nothing could paint a more accurate picture of Mr. Marsal's conflict than that intended success fee. This sale process should have followed an intensive effort to drum up the best price obtainable for the creditors. Instead, the process aims to cut off other possible sales. There is some window-dressing making it look like the sale will be tested, for the so-called "window shop" provision allows the debtors to fulfill their fiduciary obligations by permitting due diligence to occur by others with offers exceeding the claimed value of the A&M/Vestar **[**13]** offer. However, the offers have to be made first, without benefit of any dialogue with the debtors or Mr. Marsal, a state of affairs which is not optimally calculated to generate the best price obtainable. This permission for due diligence by others is small solace indeed, particularly since it is Mr. Marsal who, with his professional expertise, undoubtedly will be analyzing any competing offers should the unlikely occur and an offer be made. Moreover, Mr. Marsal testified that if I were to approve the letter agreement, it is unlikely that competing offers would be received.

The topping fee and expense reimbursement are equally problematic. The debtors claim that the business judgment rule ought be applied to determine whether these provisions should be approved. Several years ago the use of the business judgment rule was explained in the context of bankruptcy sales in this district.

> "The business judgment rule ' is a presumption that in making a business decision the directors of a

corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.' These Delaware business judgement rule principles **[**14]** have "vitality by analogy" in Chapter 11 . . . .The business judgment rule's presumption shields corporate decision-makers and their decisions from judicial second-guessing when the following elements are present: '(1) a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some courts and commentators, no abuse of discretion or waste of corporate assets.'

Integrated Resources, 147 Bankr. at 656 (citations omitted). The debtors are completely misguided in their argument, given that this is a management-sponsored leveraged buyout whose equity contribution is to be determined by the purchasers, including A&M, and that Mr. Bidermann, who is the majority shareholder, is receiving hefty incentives to cooperate with Mr. Marsal. There is lacking here both disinterestedness and due care, Mr. Marsal having executive positions with both the sellers and buyers and the debtors having apparently relied upon Mr. Marsal's opinion of what is right for them.

The debtors and the committee of unsecured creditors attempt to turn this dispute around to an attack on the motives of the objectants, who, they say, are simply trying to obtain more than the windfall **[**15]** which they will already be receiving for the claims which they acquired at a discount. There is, however, nothing inherently improper about purchasing claims at a discount. There is something to be said, in contrast, about the liquidity given to creditors through the existence of a secondary market for their claims. In any event, the motives of the objectants cannot justify what management seeks to accomplish here.

HN1[🡅] Three questions need be considered by the court when it assesses proposals for breakup fees: (1) is the relationship of the parties who negotiated the break-up fee tainted by self-dealing or manipulation; (2) does the fee hamper, rather than encourage, bidding; and (3) is the amount of the fee unreasonable relative to the proposed purchase price? Integrated Resources, 147 Bankr. at 657; *see also In re 995 Fifth Avenue Associates, L.P.*, 96 Bankr. 24 (Bankr. S.D.N.Y. 1989).

I take each question in turn. There is manifest self-dealing here. The debtors are led by Bryan Marsal and Maurice Bidermann. Both of them have agreements with Vestar which will benefit them personally if Vestar succeeds. And the whole bidding arrangement **[*553]** is designed not to encourage but to stifle **[**16]** bidding. Unlike in *Integrated*, where the debtors communicated with some 30 potential bidders and the chosen bidder was a "magnet" for the others, the debtors here did not negotiate with third party prospective purchasers, pick the best of them and then proceed to seek approval for topping and expense reimbursement fees. Rather, they determined to proceed with a management-led buyout where their chief executive officer and their majority shareholder may acquire equity in and salaries from the acquiring enterprise. When the "window shop" provision and the indemnification of Vestar are added to the equation, it can be seen that the aim is not to foster bidding. Significantly, discussions with the 30 potential bidders preceded the debtor's entry into the window shop clause in *Integrated Resources*. Not so here.

The debtors urge that although their management be found not to be disinterested, creditor participation through the committee of unsecured creditors saves the day. I understand how it is that the committee agreed to this proposal; it agreed because the proposal satisfied the arrangement earlier negotiated between the committee and the institutional note holders. However, **[**17]** once it became apparent that the debtors were amenable to a sale of the businesses, the committee should have explored whether its constituency might fare better than they would pursuant to the agreement with the note holders. The committee presented no evidence as to whether its judgment to stick by the deal with the note holders was reasonable such that, in light of the failure of the debtors to properly exercise their business judgment, the court could take comfort in the actions of and analysis by the committee. Indeed, Mr. Marsal testified that to force the note holders to go along with his offer, he and Vestar were prepared to pay the unsecured creditors in full. Yet the transaction presented does not provide this benefit to the unsecured creditors. [1] This reinforces my conclusion that the approval of the committee, negotiated before Mr. Marsal presented his plan, did not cleanse the process such that I should approve these fees.

[18]** The third question is the size of the fees relative to the consideration to be realized by the debtors. Here, the equity investment will be a maximum of $ 91 million. Unless a competing bid is in excess of $ 253 million ($ 20 million more than the asserted value of the

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[1] Some $ 26 million in claims will share in some $ 13.5 million in differing percentages depending upon the particular debtor against which their claims are asserted.

Vestar/A&M proposal), the fees to be paid will not exceed $ 4 million. This translates to a 4.4% payment. The maximum fees payable, regardless of price, will be $ 5.8 million, or 6.0%. The debtors urge that I ought measure the fees against the value of the transaction, $ 233 million. I note, however, that in *Integrated*, the case on which they rely most heavily, the court excluded from the calculation of value the debtor's cash on hand. I think it appropriate to exclude from the value the monies which are to be generated from the debtors' own assets. Viewed in this light, the fees are certainly on the high side. In addition, the debtors have effectively paid already for the would-be purchasers to acquire fluency in the debtors' affairs -- they have paid Mr. Marsal's hefty salary and that of his colleague while Mr. Marsal put together a proposal to buy the very companies which he was to save. In other words, the fees **[**19]** do not bear a reasonable relationship to the bidders' efforts. Were the magnitude of the fees the only problem with the transaction, I am confident that the problem could have been overcome. But all of the tests suggest that the fees which are requested are inappropriate.

Integrated compels no different result. I am largely in accord with its analysis, built as it is upon my earlier decision in *995 Fifth Avenue Associates, L.P.* What separates *Integrated* from this dispute is the facts: in the former, there was no self-dealing, a disinterested board of directors and a concerted effort to shop the debtors *before* the debtors selected a purchaser and agreed to a breakup fee and window shop provision.

The bottom line is that Messrs. Marsal and Bidermann have done little to ensure the integrity of this process because they are motivated by the possibility of personal gain. **[*554]** Surprisingly, Mr. Marsal testified that strategic buyers would pay more for these companies than would a financial buyer like Vestar. Yet the debtors have chosen to proceed with the A&M/management transaction without further inquiry. Transactions like this have a heavy potential to tarnish the luster of **[**20]** this practice. An insufficient record has been developed to suggest that this transaction is in the best interests of the estate. Accordingly, under the searching inquiry which is compelled by an insider sale to a professional entrusted with curing the ills of a troubled enterprise, the letter agreement must fall. Notwithstanding the delay which my decision will engender, I am obliged to ensure that the creditors are not made pawns to the professionals. In good conscience, I cannot grant this motion.

In addition, because my confidence in management and the debtors' counsel has been sorely shaken by the manner in which they sought to pursue this transaction, I am ordering the parties to show cause why an examiner with expanded powers ought not be appointed to assess the desirability of proceeding along the mapped route and to assess the fairness of any offers which may be made to the debtors for their purchase, including a Vestar offer. That motion is returnable in this courtroom on January 13, 1997 at 2:00 p.m.. Any opposition is to be set forth in a writing explaining the basis therefor which shall be filed with the court, with a copy delivered directly to my chambers, and served **[**21]** on the debtors, the committee, the institutional note holders and their counsel, counsel for the objectants and the United States Trustee, so as to be filed and served no later than January 7, 1997 at 5:00 p.m. IT IS SO ORDERED. [2]

Dated: New York, New York

January 6, 1997

Tina L. Brozman

CHIEF UNITED STATES BANKRUPTCY JUDGE

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[2] The oral bench ruling was so ordered. This written form of my decision does not constitute an order.

2015 WL 4459502
United States District Court, D. New Hampshire.

GT ADVANCED TECHNOLOGIES INC., et al., Appellants
v.
William K. HARRINGTON, United States Trustee, Appellee.

Civil No. 15–cv–069–LM.
|
Signed July 21, 2015.

Attorneys and Law Firms

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T. Richard Faloh, Orlando, FL, pro se.

ORDER

LANDYA McCAFFERTY, District Judge.

*1 Chapter 11 debtor GT Advanced Technologies, Inc. and its affiliated debtors and debtors in possession (collectively "GTAT") appeal a February 5, 2015 order of the bankruptcy court (Boroff, J.) denying their motion for approval of a proposed key employee retention plan and a proposed key employee incentive plan. Appellee William Harrington is the United States Trustee ("Trustee"). This court heard oral argument on GTAT's appeal on July 10, 2015. For the reasons that follow, this matter is remanded to the bankruptcy court for further proceedings.

I. Standard of Review

This court has jurisdiction over GTAT's appeal pursuant to 28 U.S .C. § 158(a). "The bankruptcy court's legal conclusions engender de novo review, but its factual findings are examined only for clear error." *Redondo Constr. Corp. v. P.R. Highway & Transp. Auth. (In re Redondo Constr. Corp.),* 678 F.3d 115, 120–21 (1st Cir.2012) (citing *Donarumo v. Furlong (In re Furlong),* 660 F.3d 81, 86 (1st Cir.2011)).

Until 2014, the Federal Rules of Bankruptcy Procedure ("Federal Rules") provided that a district court reviewing an appeal from a decision of the bankruptcy court was "authorized to 'affirm, modify, or reverse a bankruptcy judge's [order] or remand with instructions for further proceedings.' " *Quinn v. Quinn,* 528 B.R. 203, 205 (D.Mass.2015) (quoting Fed. R. Bankr.P. 8013). The 2014 revisions to the Federal Rules eliminated the provision cited in *Quinn. See* 10 *Collier on Bankruptcy* ¶ 8000.01, at 8000–3 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.). Even so, the court has no reason to believe that its tools for disposing of bankruptcy appeals are any different from those described in the pre–2014 iteration of Rule 8013.

II. Background

GTAT is a technology company that once produced sapphire glass. As a result of a cash liquidity crisis arising from its sapphire glass manufacturing operation, GTAT petitioned for protection under Chapter 11 of the Bankruptcy Code. At the time, it had assets of over one billion dollars. Shortly after filing its petition, GTAT suffered losses of more than 300 million dollars and laid off 820 employees, nearly 70 percent of its workforce. In addition to implementing layoffs, GTAT lost another 43 employees to voluntary attrition between the time it filed its bankruptcy petition and the date of the bankruptcy court's hearing on its motion for approval of the proposed incentive and retention plans. Among the key points of GTAT's plan for reorganization are: (1) shifting away from the manufacture of sapphire glass; (2) selling the furnaces it had previously used to manufacture sapphire glass at a facility in Mesa, Arizona; and (3) developing and manufacturing new products in the solar industry through two projects named "Merlin" and "Hyperion."

Less than three months after filing for bankruptcy protection, GTAT moved the bankruptcy court to approve: (1) a key employee incentive plan ("KEIP") that would provide bonuses for nine insiders; and (2) a key employee retention plan ("KERP") that would provide bonuses for about two dozen non-insider employees. The final versions of the KEIP and the KERP were developed on the basis of extensive negotiations with the Creditors' Committee.

*2 The proposed KEIP covers nine senior management employees. The amount of any employee's bonus under the KEIP is based upon his or her performance in five specific areas. The operative metrics are: (1) maximizing the value received for GTAT's used furnaces; (2) reducing "cash operating expense run-rate," Appellants' Br. (doc. no. 17) 9; Appellee's Br. (doc. no. 22) 7; (3) maximizing the value received for assets from the Mesa facility other than furnaces; (4) advancing the Merlin project; and (5) minimizing the costs of deinstalling furnaces at the Mesa facility. Performance in each of those five metrics is measured on a scale that runs from "threshold" through "target" to "stretch." An individual who meets the "target" standard in each of the five metrics would receive a bonus of between 19 percent and 83 percent of his or her base salary. The total cost of the KEIP runs from $1,137,500, if each insider meets the "threshold" standard in each of the five metrics, to $3,370,000, if each insider meets the "stretch" standard in each of the five metrics.

The proposed KERP covers 26 employees. The retention bonuses in the KERP are to be paid to employees who remain with GTAT until the earlier of its emergence from bankruptcy or a sale of substantially all of its assets. The bonuses range from eight percent to 48 percent of an employee's base salary, and the KERP also provides for discretionary disbursements by GTAT's chief executive officer, up to a total of $300,000, with no more than $50,000 going to any individual KERP participant. If all the proposed bonuses are paid, the KERP will cost GTAT $1,250,000.

The bankruptcy court held a hearing on GTAT's motion for approval of its KEIP and KERP. Only two objections were filed, one by the Trustee and one by a shareholder. At the hearing, the bankruptcy court heard testimony from: Andrew Pfeifer [1] and Brian Cumberland, [2] and had before it declarations from those two witnesses as well as declarations from Neil Augustine [3] and Richard Newsted. [4] At the conclusion of the hearing, the court ruled from the bench. With regard to the KEIP, Judge Boroff had this to say:

> I have before me the KEIP and the KERP. I listened very closely to the testimony of Mr. Pfeifer and Mr. Cumberland, Mr. Augustine and Mr. Newsted, as well as the impressive work that was done by them and by the Creditors' Committee, its professionals and counsel for the debtor in order to fashion something that they thought might work.
>
> Nevertheless, what I heard every time I inquired with respect to the KEIP was how problematic it would be if the executive team—I think at one point it was referred to as Mr. Gutierrez and his lieutenants—left the company. It was critical to retain them.
>
> Well, in the absence of a statutory prohibition I could be persuaded to go along with that, but Congress has spoken very clearly on retention agreements [for insiders]. This is a disguised retention agreement. I do not believe that Mr. Gutierrez or his so-called lieutenants are going to work any less diligently if I don't approve the agreement or any more diligently if I do approve the KEIP agreement. They will leave the company or stay with the company based on their expectation that the company will survive and how well it will do in its reorganized form.
>
> *3 Retention agreements [for insiders], Mr. Despins said at the outset, have been made extraordinarily difficult—he might have said impossible and I might agree with him—by Section 503(c) of the Bankruptcy Code and the elements of 503(c)(1) ... have simply not been met and so I cannot approve the KEIP agreement.

J.A. (doc. no. 18), at JA–000918–000919. Judge Boroff also declined to approve the KERP:

> With respect to the KERP plan, those are individuals who have a very difficult decision to make.

> They need to decide whether they will stay with the company or not. To stay with the company means that they are investing in the company's success and if they decide to leave, then the amount of money that's being offered to them is dramatically lower than the risk that they're trying to avoid. If, in fact, they think that the company will fail—and I've every expectation that they're still there because they anticipated success—but if they change their mind[s] and decide that the company may fail and they get themselves another job offer, then it seems to me that the ... retention payment ... is not going to keep them at the company's premises. They're going to leave in order to protect themselves and their families.

Id. at JA–000919–000920. The judge concluded his ruling this way:

> And so really, we're talking about the KEIP or the KERP. I believe that the various proposed participants all—have already ... sufficient incentive or disincentive to stay and the payments proposed are going to make no difference whatsoever either as to their performance or as to their willingness to remain in the company's ... employ.
>
> Accordingly, I find [and] I rule ... that while the KEIP simply doesn't satisfy the statute because it is [a] disguised retention program [and] the KERP falls below the business judgment standard. Accordingly, I will deny both motions.

Id. at JA–000920.

III. Discussion

On appeal, GTAT argues that the bankruptcy court erred by: (1) applying the wrong legal standard to its consideration of the KEIP; and (2) improperly substituting its own business judgment for that of GTAT when assessing both the KEIP and the KERP. This court considers each plan in turn.

A. Key Employee Incentive Plan

With respect to approval of the KEIP, the parties agree that the rule of decision comes from 11 U.S.C. § 503, which governs the allowance of administrative expenses. The point of disagreement concerns which provision of § 503 applies. Section 503 provides, in pertinent part:

> **(c)** Notwithstanding subsection (b), there shall neither be allowed, nor paid—
>
> **(1)** 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, absent a finding by the court based on evidence in the record that—
>
> **(A)** the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
>
> ***4** ....
>
> **(3)** other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

11 U.S.C. § 503(c). While § 503(c)(1) refers to transfers to insiders, § 503(c)(3) includes no such limitation, and the phrase "officers, managers, or consultants" would appear to include persons who fall outside the applicable statutory definition of "insider." *See* 11 U.S.C. § 101(31)(B).

According to GTAT, the bankruptcy court erred by finding the KEIP to be a retention plan for insiders and applying § 503(c)(1) rather than treating the KIEP as an incentive plan and applying § 503(c)(3). Determining which provision applies is significant because GTAT conceded at oral argument that it cannot meet the requirements of § 503(c)(1)(A)-(C).[5] *See also* J.A., at JA–000722.

The dispositive question is whether the bankruptcy court correctly determined that the KEIP is a retention plan rather than some other kind of obligation outside of the ordinary course of business. If so, the court correctly decided not to approve it, pursuant to 11 U.S.C. § 503(c)(1). If not, the court erred by using § 503(c)(1) rather than § 503(c)(3) to evaluate the KEIP.

In a recent decision from the Eastern District of Missouri, Judge Surratt–States set out the relevant substantive law:

> Congress added Section 503(c) to the Bankruptcy Code in 2005 to "eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process." *In re Global Home Prods., LLC,* 369 B.R. [778,] 784 [(Bankr.D.Del.2007)] (internal quotations omitted). A court "must examine a proposed [incentive plan] ... and determine whether the proposed targets are designed to motivate insiders to rise to a challenge or merely report to work." *In re Hawker Beechcraft, Inc .,* 479 B.R. 308, 313 (Bankr.S.D.N.Y,2012) (citing *In re Velo Holdings,* 472 B.R. [201,] 209 [(Bankr.E.D.N.Y.2012)]. A plan that does not require affirmative action beyond that contemplated prepetition is not incentive, but is retentive and cannot be approved under the more lenient standards for incentive plans. *See In re Residential Capital, LLC [(Residential Capital I)],* 478 B.R. 154, 171–73 (Bankr.S.D.N.Y.2012). A court must determine whether the debtor has proposed a retentive plan disguised as an incentive plan in order to circumvent the requirements of Section 503(c)(1). *In re Velo Holdings, Inc.,* 472 B.R. at 209. "Although a purported [incentive plan] may contain some retentive effect, that does not mean that the plan, overall, is retentive rather than incentivizing in nature." *Id.* at 209–10 (citing *In re Dana Corp. ("Dana I"),* 351 B.R. 96, 102 (Bankr.S.D.N.Y.2006)). The burden of proof that the incentive plan is not a retentive plan lies with the proponent of the plans. *In re Hawker Beechcraft, Inc.,* 479 B.R. at 313.

***5** *In re Patriot Coal Corp.,* 492 B.R. 518, 531 (Bankr.E.D.Mo.2013). A plan proponent must satisfy its burden of proof by a preponderance of the evidence. *See In re Residential Capital, LLC (Residential Capital II),* 491 B.R. 73, 86 (Bankr.S.D.N.Y.2013) (citation omitted).

In this case, the bankruptcy court determined that the KEIP was subject to 11 U.S.C. § 503(c)(1) because it was a retention plan disguised as an incentive plan. Indeed, "[a]ttempts to characterize what are essentially prohibited retention programs as 'incentive programs' in order to bypass the requirements of section 503(c)(1) are looked upon with disfavor." *Velo Holdings,* 472 B.R. at 209. To determine whether a retention program has been disguised as an incentive program, "courts consider the circumstances under which particular proposals are made, along with the structure of the compensation packages." *Id.* (citing *Dana I,* 351 B.R. at 102). With regard to the structure of a compensation package, for a bonus to qualify as "an incentive payment, the plan must present targets that are difficult to achieve, forcing the executives to work hard to achieve their bonuses." *Residential Capital II,* 491 B.R. at 86.

The problem with the bankruptcy court's decision in this case is that it ruled that the KEIP was a disguised retention plan without making any findings on the key question, *i.e.,* whether the KEIP incorporates targets that are difficult to achieve. The reported decisions in cases in which bankruptcy courts have been called upon to determine whether a compensation program is a legitimate incentive plan or a disguised retention plan generally contain detailed analyses of the plans at issue. *See, e.g., Patriot Coal,* 492 B.R. at 532–33; *Residential Capital II,* 491 B.R. at 86–87; *Hawker Beechcraft,* 479 B.R. at 313–15. Here, there is none of that. Rather, the bankruptcy court relied exclusively upon statements from witnesses concerning the importance of GTAT's executive team to the success of its reorganization.

To be sure, some bankruptcy courts have mentioned the importance of retaining key executives when denying approval for incentive plans. *See, e.g., Hawker Beechcraft,* 479 B.R. at 314; *Residential Capital I,* 478 B.R. at 168 n. 2. But, this court has found no case, and the Trustee has identified none, in which a bankruptcy court has declined to approve a proposed incentive plan for insiders based solely upon testimony concerning the importance of those insiders to the debtor's business. Moreover, while the bankruptcy court cited such testimony in *Residential Capital I,* the plan proponent in that case proposed a second insider incentive plan that was approved in *Residential Capital II,* notwithstanding the testimony reported in *Residential Capital I.* The second plan was approved because it had stronger metrics than the first plan, *see Residential Capital II,* 491 B.R. at 87, and the analysis of the metrics in *Residential Capital I* necessarily gave the plan proponent guidance on how to draft the plan that was accepted in *Residential Capital II.* In contrast, the lack of analysis in the bankruptcy court's decision in this case makes it impossible for GTAT to propose an alternative KIEP that might be accepted. Affirming the bankruptcy court's rejection of the KEIP for the reasons given in its decision would require this court to endorse the proposition that any mention of retentive effects by the proponent of an incentive plan would preclude the approval of any plan advanced by that proponent. That proposition, however, is inconsistent with the well accepted principle that a compensation plan does not lose its character as an incentive plan just because it has some retentive effect. *See Patriot Coal,* 492 B.R. at 531.

***6** To sum up, the bankruptcy court's failure to properly analyze the structure of the compensation package in GTAT's proposed KEIP is an error of law that requires remand. [6] On remand, the bankruptcy court is instructed to determine whether the proposed KEIP has sufficiently stringent metrics to qualify as an incentive plan for the purposes of 11 U.S.C. § 503(c).

This court appreciates that GTAT has a strong interest in a quick resolution of this matter, and would prefer for this court to undertake the requisite analysis and rule in its favor without remand. However, it is better for the bankruptcy court, in the first instance, to make the findings of fact and rulings of law necessary to decide whether the targets in GTAT's proposed KEIP are sufficiently rigorous for the KEIP to qualify as an incentive plan. However, given the extensive record that has already been generated, this court can see no reason why the bankruptcy court would need to take any further evidence, which should allow it to act relatively quickly in response to this remand order.

B. Key Employee Retention Plan

With respect to approval of its proposed KERP, GTAT argues that the rule of decision comes from 11 U.S.C. § 363(b)(1), which governs the use, sale, or lease of property of the bankruptcy estate "other than in the ordinary course of business." The Trustee contends that the rule of decision comes from 11 U.S.C. § 503(c)(3), which governs administrative expenses, including "other transfers or obligations that are outside the ordinary course of business." The Trustee has the better argument.

In *Patriot Coal,* the court had before it an employee retention plan. *See* 492 B.R. at 527. After determining that the plan did not cover any insiders, which would have subjected it to scrutiny under § 503(c)(1), the court acknowledged § 363(b)(1) but applied § 503(c)(3). *See id.* at 536; *see also Residential Capital II,* 491 B.R. at 84–85 (analyzing retention plan for non-insiders under § 503(c)(3)); *In re Global Aviation Holdings Inc.,* 478 B.R. 142, 150 (Bankr.E.D.N.Y.2012) (same). As Judge Glenn explained in *Residential Capital II:* "Transfers made in the ordinary course of business are evaluated under section 363(c). Transfers to insiders, or transfers made outside the ordinary course of business, are subject to the requirements of section 503(c)." 491 B.R. at 82. It would seem that Judge Glenn viewed § 503(c)(3) as superseding § 363(b)(1) as the statute governing the evaluation of transfers, other than retention payments to insiders, that are made outside the ordinary course of business.

In any event, *Patriot Coal, Residential Capital II,* and *Global Aviation* all stand squarely for the proposition that retention programs for non-insiders should be evaluated under the § 503(c)(3) "facts and circumstances" test. That said, the court must also note that in each of those three cases, the "facts and circumstances" test was treated as equivalent to the business judgment test that courts apply under § 363(b)(1). *See, e.g., Patriot Coal,* 492 B.R. at 531 (citing *Velo Holdings,* 472 B.R. at 212; *In re Dana Corp. (Dana II),* 358 B.R. 567, 576 (Bankr.S.D .N.Y.2006)). That is where this court parts company with *Patriot Coal, Residential Capital II,* and *Global Aviation* and instead, relies upon *In re Pilgrim's Pride Corp.,* 401 B.R. 229 (Bankr.N.D .Tex.2009).

***7** In *Pilgrim's Pride,* the court was faced with an incentive plan for insiders that was subject to analysis under § 503(c)(3) and its "facts and circumstances" test. *See* 401 B.R. at 236. In determining the scope of review under that test, Judge Lynn relied upon various principles of statutory construction to reject the debtor's argument that the "facts and circumstances" test was the same as the § 363(b)(1) business judgment rule, under which "[a] debtor's business decision should be approved by the court unless it is shown to be so manifestly unreasonable that it could not be based upon sound business judgment, but only on bad faith, or whim or caprice." *In re SW Boston Hotel Venture, LLC,* No. 10–14535–JNF, 2010 WL 3396863, at *3 (Bankr.D.Mass. Aug. 27, 2010) (quoting *White v. Official Comm. of Unsecured Creditors (In re*

Cadkey Corp.), 317 B.R. 19, 22–23 (D.Mass.2004)).[7] After rejecting the debtor's argument, the court described the "facts and circumstances" test this way:

> In applying the simple business judgment test, courts are adjured to defer to the debtor in possession or trustee; if a valid business reason is shown for a transaction, the transaction is to be presumed appropriate. *See* 7 *Collier on Bankruptcy* ¶ 1108.06 (15th ed. rev.2006).
>
> The court concludes that section 503(c)(3) is intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it. The court reads this requirement as meaning that the court must make its own determination that the transaction will serve the interests of creditors and the debtor's estate.
>
> *Pilgrim's Pride,* 401 B.R. at 237. "Although it has become the minority view, the court in *Pilgrim's Pride Corp.* articulated sound reasons for imposing a test stricter than the business judgment test in section 363(b)." 4 *Collier on Bankruptcy, supra,* ¶ 503.17[4], at 503–116. This court is persuaded by *Pilgrim's Pride* that 11 U.S.C. § 503(c)(3) directs courts to give more scrutiny to the business judgment of debtors than is permitted under the § 363(b)(1) business judgment test.

In reaching that conclusion, the court acknowledges that *Pilgrim's Pride* was an insider incentive plan case rather than a non-insider retention plan case, which means that Judge Lynn did not need to "decide whether section 503(c)(3) was intended to reach beyond transactions with insiders." 401 B.R. at 236. Judge Lynn did not decide that issue, but, as noted above, several other judges have determined that § 503(c)(3) does govern transfers to non-insiders. *See, e.g., Patriot Coal,* 492 B.R. at 536. Moreover, while the judges in those cases may have based their reliance upon § 503(c)(3) on a belief that the "facts and circumstances" test was the same as the § 363(b)(1) business judgment test, Judge Lynn's statutory analysis is persuasive. Beyond that, nothing in § 503(c) suggests that: (1) § 503(c)(3) was intended to be limited to transfers or obligations to insiders; or (2) the facts and circumstances test was intended to operate one way with respect to incentive plans for insiders and another way with respect to retention plans for non-insiders. In short, the factual distinctions between this case and *Pilgrim's Pride* do nothing to diminish this court's conviction that § 503(c)(3) directs courts to give plans such as the KERP in this case more scrutiny than is required by the § 363(b)(1) business judgment test.

***8** Having determined the proper level of scrutiny, the court turns to a more straightforward issue, *i.e.,* the substantive framework for a bankruptcy court's review of a compensation plan under § 503(c)(3). To determine whether a compensation plan is "justified by the facts and circumstances of the case," 12 U.S.C. § 503(c)(3), courts typically consider what have come to be known as the *Dana* factors:

> —Is there a reasonable relationship between the plan proposed and the results to be obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, is the plan calculated to achieve the desired performance?
>
> —Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?
>
> —Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?
>
> —Is the plan or proposal consistent with industry standards?
>
> —What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?
>
> —Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

Patriot Coal, 492 B.R. at 531 (quoting *Dana II,* 358 B.R. at 576–77) (emphasis omitted); *see also Residential Capital II,* 491 B.R. at 84–85 (employing the *Dana* factors to determine whether to approve retention plan for non-insider employees); *Global Aviation,* 478 B.R. at 150–51 (same).

With respect to the KERP in this case, the bankruptcy court found that the proposed retention payments were not likely to inspire the targeted employees to stay with the company and ruled that "the KERP falls below the business judgment standard." J.A., at JA–000920.

There are two fundamental problems with the bankruptcy court's decision. First, it would appear that the court considered, at most, only the first of the six *Dana* factors. Second, while the decision refers to the "business judgment standard," it is not clear whether the court applied the highly deferential § 363(b)(1) test or the less deferential test from *Pilgrim's Pride.* Without knowing which standard the bankruptcy court employed, this court cannot undertake a meaningful review. The bankruptcy court's inadequate consideration of the *Dana* factors and its failure to specify its standard of review are errors of law that require remand. On remand, the bankruptcy court is instructed to: (1) analyze the proposed KERP in terms of the *Dana* factors; and (2) do so with the level of scrutiny described in *Pilgrim's Pride.*

IV. Conclusion

For the reasons described above, this matter is remanded to the bankruptcy court for further proceedings consistent with this order.

SO ORDERED.

All Citations

Not Reported in F.Supp.3d, 2015 WL 4459502, 2015 DNH 144

Footnotes

1 Pfeifer is "the Senior Director of Corporate Compensation and Benefits at GT." J.A. (doc. no. 18), at JA–000627.

2 Cumberland is "the National Managing Director of the Compensation & Benefits practice at Alvarez & Marsal Taxand, LLC ..., the tax consulting practice of Alvarez and Marsal North America, LLC." J.A., at JA–000635.

3 Augustine is "an Executive Vice Chairman of Rothschild Inc." J.A., at JA–000662. Rothschild "provided extensive pre-petition services to [GT] in preparation for [its] restructuring efforts." *Id.* at JA–000664.

4 Newsted is "an independent member of the Board of Directors of GT ... (the 'Board'), and ... a member of the Restructuring Committee of the Board." J.A., at JA–000615.

5 In addition to providing that an insider must hold a bona fide job offer before he or she may receive a retention bonus, § 503(c)(1) also requires that:

(B) the services provided by the person are essential to the survival of the business; and

(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred.

11 U.S.C. § 503(c)(1).

6 If the bankruptcy court had made factual findings to support its ruling that the KEIP is a disguised retention plan, based upon the weakness of its metrics, those findings would be subject to clear error review. But where, as here, the bankruptcy court has not made the necessary findings, its failure to do so is an error of law.

7 The § 363(b)(1) business judgment test has also been characterized as barring the bankruptcy court from substituting its judgment for that of the trustee or the debtor in possession. *See* 3 *Collier, supra,* ¶ 363.02[4], at 363–19.

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In re Global Aviation Holdings Inc.

United States Bankruptcy Court for the Eastern District of New York

July 24, 2012, Decided; July 24, 2012, Filed

Chapter 11, Case Nos. 12-40783 (CEC), 12-40782 (CEC), 12-40784 (CEC), 12-40785 (CEC), 12-40786 (CEC), 12-40787 (CEC), 12-40788 (CEC), 12-40789 (CEC), 12-40790 (CEC), Jointly Administered

Reporter
478 B.R. 142 *; 2012 Bankr. LEXIS 3437 **

In re: GLOBAL AVIATION HOLDINGS INC., et al., Debtors.

Core Terms

Employees, insider, bonus, bonuses, operations, relocation, positions, retention, senior, bonus payment, facts and circumstances, vice president, due diligence, replacement, consultant, pre-petition, declaration, regulations, argues, grades, elect, reorganization, non-insiders, requirements, executives, recipients, airline, delayed, refers, lease

Case Summary

Procedural Posture

Debtors, an aviation holdings company and affiliated businesses, filed petitions under Chapter 11 of the Bankruptcy Code and sought entry of an order approving a key employee retention plan ("KERP") pursuant to *11 U.S.C.S. §§ 363(b)* and *503(c)(3)*. The United States Trustee ("UST") and an official committee of unsecured creditors filed objections to the debtors' motion.

Overview

The aviation holdings company owned an airline that was headquartered in New York and an airline that was headquartered in Georgia, and it proposed to reorganize its business by consolidating both headquarters in Georgia and asked the court to approve a KERP that offered bonuses to five employees so they would remain with the company and move to Georgia. Although the UST and a committee of unsecured creditors claimed that the KERP could not be approved under *11 U.S.C.S. § 503(c)(1)* because it paid bonuses to insiders, the court found that employees who would be paid bonuses under the KERP were not insiders under *11 U.S.C.S. § 101(31)(B)* because they were not persons "in control" of the debtors within the meaning of *§ 101(31)(B)(iii)*. The court evaluated the KERP under *§ 503(c)(3)*, and found that the debtors established a valid basis for paying the bonuses. All five employees worked for the New York-based airline in positions where they were required to satisfy Federal Aviation Administration requirements so that the New York-based airline could moves its headquarters to Georgia.

Outcome

The court stated that it would enter a separate order which overruled the UST's objection and the committee's objection to the debtors' KERP and approved the debtors' motion. If any one of the five employees who were identified in the KERP quit his job and had to be replaced, the move to Georgia would have been delayed and the debtors would have incurred additional costs.

LexisNexis® Headnotes

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN1[] **Reorganizations, Key Employee Retention Plans**

11 U.S.C.S. § 503(c)(1) prohibits the payment of a retention bonus to an insider unless (i) the insider has a bona fide job offer that pays at least the same rate of compensation, (ii) the insider performs services that are essential to the survival of the business, and (iii) the proposed amount of bonus for the insider is (x) not greater than an amount equal to 10 times the mean amount of any bonuses paid to nonmanagement employees during the current calendar year, or (y) if no such bonuses were paid to nonmanagement employees during the current calendar year, not greater than an amount equal to 25 percent of the amount of any bonuses paid to an insider in the preceding calendar year.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN2[] Reorganizations, Key Employee Retention Plans

Congress has built by design a set of challenging standards and high hurdles for the payment of retention bonuses to insiders. However, if employees who are offered bonuses under a key employee retention plan are not insiders, the proposed bonuses must be evaluated in a Chapter 11 bankruptcy case under 11 U.S.C.S. § 503(c)(3), which prohibits payments to employees outside the ordinary course which are not justified by the facts and circumstances of the case.

Bankruptcy Law > General Overview

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN3[] Bankruptcy Law

With respect to a debtor that is a corporation, the Bankruptcy Code's definition of an "insider" includes (i) a director of the debtor, (ii) an officer of the debtor, (iii) a person in control of the debtor, (iv) a partnership in which a debtor is a general partner, (v) a general partner of the debtor, or (vi) a relative of a general partner, director, officer, or person in control of a debtor. *11 U.S.C.S. § 101(31)(B)*. Neither "officer" nor "director" is defined in the Bankruptcy Code. However, courts have relied on dictionary definitions of these terms. A "director" is an individual who sits on the board of directors of a debtor. An "officer" is a person elected or appointed by a board of directors to manage the daily operations of a corporation, such as the CEO, president, secretary, or treasurer.

Bankruptcy Law > General Overview

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN4[] Bankruptcy Law

The label an employer chooses to attach to a position is not dispositive for purposes of an "insider" analysis under the Bankruptcy Code because companies often give employees the title "director" or "director-level" but do not give them decisionmaking authority akin to an executive. Likewise, titles such as "vice president" are not determinative. On the other hand, a person can be found to be an insider even if that person does not hold a position enumerated in *11 U.S.C.S. § 101(31)(B)*. The statutory definition is merely illustrative, and the term "insider" should be flexibly applied on a case-by-case basis. An employee's insider status can also be determined on a case-by-case basis based on the totality of the circumstances, including the degree of an individual's involvement in a debtor's affairs. To find that a person who is not listed in *§ 101(31)(B)* is an insider, the United States Bankruptcy Court for the Southern District of New York held, in In re Borders Group, that a court must determine that such a person has at least a controlling interest in a debtor or exercises sufficient authority over the debtor so as to unqualifiably dictate corporate policy and the disposition of corporate assets.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN5[] Reorganizations, Key Employee Retention Plans

The legislative history of *11 U.S.C.S. § 101(31)(B)* makes it clear that Congress was concerned with situations where an insider has a sufficiently close relationship with a debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor. In the context of enacting the limitations set forth in 11 U.S.C.S. § 503(c), Congress was responding to an inherently unseemly public perception that Chapter 11 bonus programs had been used to lavishly reward--at the expense of the creditor body--the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN6[] **Reorganizations, Key Employee Retention Plans**

The appropriate standard for determining whether an "outside the ordinary course" compensation proposal is justified by the facts and circumstances of a given case was articulated by the United States Bankruptcy Court for the Southern District of New York in In re Dana Corp. as follows: (1) whether the plan has a reasonable relationship to the results to be obtained; (2) whether the cost is reasonable in light of the debtor's assets, liabilities, and earnings potential; (3) whether the scope of the plan is fair and reasonable or discriminates unfairly; (4) whether the plan comports with industry standards; (5) whether the debtor undertook due diligence in investigating the need for a plan, the employees that should be incentivized, and market standards; and (6) whether the debtor received independent counsel in performing due diligence in creating and authorizing the incentive compensation.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN7[] **Reorganizations, Key Employee Retention Plans**

No showing of a bona fide job offer or any other evidence of an intent to leave employment is required to pay a bonus to non-insiders under *11 U.S.C.S. § 503(c)(3)*.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN8[] **Reorganizations, Key Employee Retention Plans**

Discrimination in the payment of bonuses to key employees is permitted in a Chapter 11 bankruptcy case as long as it is fair because different employees may have different values to a debtor's reorganization efforts. No unfair discrimination exists if the pool of bonus recipients is not limited to the most senior executives and is broad enough to include lower-ranking employees vital to the Chapter 11 bankruptcy process.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN9[] **Reorganizations, Key Employee Retention Plans**

The United States Bankruptcy Court for the Eastern District of New York held in In re Brooklyn Hosp. Center that due care was exercised in crafting a key employee retention plan where the board of directors consulted with its counsel and financial advisors, formulated several proposals, reduced the amount to be paid pursuant to a bonus program, and, after negotiations with an official committee of unsecured creditors, broadened the scope of employees included and added a mitigation clause to the severance payment provision.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN10[] **Reorganizations, Key Employee Retention Plans**

The sixth factor the United States Bankruptcy Court for the Southern District of New York identified in In re Dana Corp. for determining whether an "outside the ordinary course" compensation proposal is justified by the facts and circumstances of a given case deals with whether a debtor received independent counsel in performing due diligence and in authorizing a retention bonus. However, the lack of independent counsel is not fatal.

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For The Official Committee of Unsecured Creditors: Jason Teele, Esq., Sharon Levine, Esq., Cassandra M. Porter, Esq., Lowenstein Sandler PC, Roseland, New Jersey.

For Tracy Hope Davis, United States Trustee for Region 2: Andrea B. Schwartz, Esq., U.S. Department of Justice, New York, New York.

Judges: Carla E. Craig, Chief United States Bankruptcy Judge.

Opinion by: Carla E. Craig

Opinion

[*144] DECISION

Carla E. Craig

Chief United States Bankruptcy Judge

This matter comes before the Court on the motion (the "Motion") of Global Aviation Holdings, Inc. and its affiliated debtors (collectively, the "Debtors") for the entry of an order approving a key employee retention plan (the "KERP") pursuant to §§ 363(b) and 503(c)(3) of Title 11 of the United States Code **[*145]** (the "Bankruptcy Code").[1] The United States Trustee for Region 2 (the "UST") and the Official Committee of Unsecured Creditors (the "Committee") filed objections to the Motion, arguing that the Debtors are improperly seeking to pay bonuses (i) to insiders without satisfying the requirements set forth in § 503(c)(1) or (ii) **[**2]** to the extent the KERP recipients are non-insiders, without establishing that the proposed bonus payments are "justified by the facts and circumstances of the case" as required by § 503(c)(3). An evidentiary hearing was held on July 11, 2012. For the reasons set forth below, the employees eligible to receive compensation under the KERP are not insiders of the Debtors, and because the Debtors have established that the KERP is "justified by the facts and circumstances of the case," the objections of the UST and the Committee are overruled and the Motion is granted in its entirety.

JURISDICTION

This Court has jurisdiction over this matter pursuant to *28 U.S.C. §1334(b)*, and the Eastern District of New York standing order of reference dated August 28, 1996. This matter is a core proceeding under *28 U.S.C. §§ 157(b)(2)(A)*, *157(b)(2)(B)* and *157(b)(2)(M)*. This Decision constitutes the Court's findings of fact and conclusions of law to the extent required by Rule 7053 of the Federal Rules of Bankruptcy Procedure.

BACKGROUND

On February 5, 2012 (the "Petition Date"), the Debtors filed **[**3]** petitions for relief under chapter 11 of the Bankruptcy Code. The Debtors operate two airlines: North American Airlines, Inc., ("North American") and World Airways, Inc. ("World"). North American's headquarters is currently located at JFK International Airport in Jamaica, New York, while World's headquarters is located in Peachtree City, Georgia. The Debtors, as part of their reorganization strategy, have decided to consolidate their operations by relocating North American's operations from JFK International Airport to Peachtree City, Georgia. According to the Debtors, their business plan contemplates the completion of this relocation process by August 31, 2012.

On June 15, 2012, the Debtors filed the Motion[2] seeking Court approval of the KERP under which the Debtors would pay bonuses to five employees of North American: 1) the Director of Safety; 2) the Vice President of Operations; 3) the Chief Pilot; 4) the Senior Director of Maintenance; and 5) the Chief Inspector (collectively, the "KERP Employees"). The proposed bonus payments under the KERP are structured as a percentage of each KERP Employee's base salary and in accordance with the Debtors' pre-petition annual bonus plan. The **[**4]** proposed payouts are intended to ensure that each of the KERP Employees remains with the Debtors through the relocation of North American's operations to Peachtree City. Set forth below is the amount of the bonus that each KERP Employee will receive upon the approval by the Federal Aviation Administration (the "FAA") of the transfer of North American's operations to Georgia:

- Director of Safety: $18,050
- Vice President, Flight Operations: $50,696
- Chief Pilot: $29,355

[*146] • Senior Director of Maintenance: $15,750
- Director, Quality Assurance and Projects: $23,180

In the aggregate, the Debtors seek to pay the KERP Employees bonuses totaling $137,031.

In support of the Motion, the Debtors filed the declaration of William A. Garrett, the Executive Vice President and Chief Financial Officer of the Debtors. In his declaration, Mr. Garrett explains that the relocation of North American is contingent on the FAA making a determination that North American's operations, maintenance, and safety departments are functioning consistently in Peachtree City as they were functioning at JFK International Airport. (Dec. at ¶ 5.)[3] Mr. Garrett

[1] Unless otherwise indicated, statutory citations herein are to provisions of Title 11 of the United States Code.

[2] [Docket No. 436]

[3] "Dec." refers to the Declaration of William A. Garrett, **[**6]** dated June 15, 2012. "Supp. Dec." refers to the

asserts that the retention of the KERP Employees **[**5]** is critical to securing FAA approval because the KERP Employees oversee the operations, maintenance, and safety departments of North American. (Id. at ¶ 6.) The Debtors point out that the FAA regulations, codified at *14 C.F.R. § 119.65*, specifically mandate that a commercial airplane operator "have qualified personal serving full time" in each of the five positions filled by the KERP Employees. (Id. at ¶5.) Because the FAA considers the tenure of the employees who fill these positions and the extent and nature of their preexisting relationships with the FAA in determining if the personnel are qualified, the Debtors believe that if even one of the KERP Employees were to leave North American in the coming weeks, FAA approval of the relocation would be delayed beyond August 31, 2012. (Id. at ¶ 6.) The Debtors point out that the lease costs alone at the JFK International Airport location amount to $132,000 per month, approximately the total amount of the proposed payments under the KERP. (Supp. Dec. at ¶ 9.) Any delay, therefore, will result in a loss of cost savings that exceeds the proposed bonuses to be paid to the KERP Employees.

On July 3, 2012, the Committee filed an objection to the Motion.[4] The Committee's objection is two-fold. First, the Committee disputes the Debtors' characterization of the KERP Employees as "non-insiders." The Committee asserts that the KERP Employees have oversight authority over areas of North American's corporate policy consistent with the status of insiders. The Committee contends that these proposed bonuses must therefore be reviewed under *§ 503(c)(1)*, which requires evidentiary showings that the Debtors have not made. Second, the Committee argues that even if the KERP Employees are determined not to be insiders, the Debtors have still not met the standard for permissible bonus payments outside the ordinary course of business set forth in *§ 503(c)(3)*.

The UST also filed an objection to the Motion on July 3, 2012.[5] The UST argues that the Debtors have failed to provide sufficient evidence to establish that one of the KERP Employees— the Director of Safety— is not an insider of the Debtors. The UST further argues that, whether or not the Director of **[**7]** Safety is an insider of the Debtors, the Debtors have not carried their burden of proof to demonstrate that the proposed bonuses to the KERP Employees are permissible under *§ 503(c)(3)*.

On July 9, 2012, in response to the Committee and the UST's objections, the Debtors **[*147]** filed an omnibus reply[6] arguing that, under applicable case law, the KERP Employees are not insiders and that the decision to proceed with the KERP is within their business judgment. With the omnibus reply, the Debtors also filed a supplemental declaration by Mr. Garrett.

On July 11, 2012, a hearing was held on the Motion, at which Mr. Garrett testified in further support of the Motion.

DISCUSSION

The Motion must be evaluated under the standards set forth in *§ 503(c)*, as enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. The threshold inquiry is whether all, or any, of the KERP Employees are insiders of the Debtors such that the proposed bonus payments under the KERP fall within the purview of *§ 503(c)(1)*.

A. Insider Analysis

If a KERP Employee is an insider of the Debtors, then he or she is precluded from receiving a retention **[**8]** bonus unless the strict requirements outlined in *§ 503(c)(1)* are met. ***HN1***[🡅] That section prohibits the payment of a retention bonus to an insider unless: (i) the insider has a bona fide job offer that pays at least the same rate of compensation, (ii) the insider performs "services . . .[that] are essential to the survival of the business," and (iii) the proposed amount of bonus for the insider is (x) not greater than an amount equal to 10 times the mean amount of any bonuses paid to nonmanagement employees during the current calendar year or (y) if no such bonuses were paid to nonmanagement employees during the current calendar year, not greater than an amount equal to 25 percent of the amount of any bonuses paid to the insider in the preceding calendar year. *11 U.S.C. § 503(c)(1)*.

HN2[🡅] Congress has built by design "a set of challenging standards" and "high hurdles" for the payment of retention bonuses to insiders. *In re Global Home Prods., LLC, 369 B.R. 778, 784-85 (Bankr. D.*

Supplemental Declaration of William A. Garrett, dated July 9, 2012.

[4] [Docket No. 473]

[5] [Docket No. 474]

[6] [Docket No. 480]

Del. 2007). Here, the Debtors concede that none of the KERP Employees has a bona fide job offer. (Tr. 147: 9-12.)[7] Accordingly, a finding that the KERP Employees are insiders would be fatal to the Motion. If, on the other **[**9]** hand, the KERP Employees are not insiders, the proposed bonuses under the KERP must be evaluated under § 503(c)(3), which prohibits payments to employees outside the ordinary course which are "not justified by the facts and circumstances of the case."

HN3[] With respect to a debtor that is a corporation, the Bankruptcy Code's definition of an "insider" includes a:

(i) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;
(iv) partnership in which the debtor is a general partner;
(v) general partner of the debtor; or
(vi) relative of a general partner, director, officer, or person in control of the debtor.

11 U.S.C. § 101(31)(B).

Neither "officer" or "director" is defined in the Bankruptcy Code. *In re Borders Group, Inc., 453 B.R. 459, 468 (Bankr. S.D.N.Y. 2011)*. However, courts have relied on dictionary definitions of these terms. As the court explained in Borders Group, a director is "an individual who sits on the board of directors" of a **[*148]** debtor. Id. (citing *Rupp v. United Security Bank (In re Kunz), 489 F.3d 1072, 1077 (10th Cir. 2007)*). **[**10]** An officer "is defined as a 'person elected or appointed by the board of directors to manage the daily operations of a corporation, such as the CEO, president, secretary, or treasurer.'" Id. (citing BLACK'S LAW DICTIONARY 1193 (9th ed. 2009)).

The fact that some of the KERP Employees have the word "director" in their titles does not make them insiders. **HN4**[] The label an employer chooses to attach to a position is not dispositive for purposes of insider analysis because "[c]ompanies often give employees the title 'director' or 'director-level' but do not give them decision-making authority akin to an executive." *Id. at 469*. See also *In re Foothills Texas, Inc., 408 B.R. 573, 579 (Bankr. D. Del 2009)* (holding that the "mere title of a person does not end the inquiry."). Likewise, titles such as "vice president" are not determinative. For example, in *In re NMI Systems, Inc., 179 B.R. 357, 370 (Bankr. D.D.C. 1995)*, the court found that a vice president was not an insider because he was conferred the title "for purposes of marketing" only and as a direct report of another vice president, he was not "in the inner circle making the company's critical financial decisions."

On the other hand, a person **[**11]** can be found to be an insider even if that person does not hold a position enumerated in *§ 101(31)(B)*. The statutory definition "is merely illustrative and the term insider should be flexibly applied on a case by case basis." *In re 9281 Shore Road Owners Corp., 187 B.R. 837, 853 (E.D.N.Y. 1995)*. An employee's "[i]nsider status can also be determined on a case by-case basis based on the totality of the circumstances, including the degree of an individual's involvement in a debtor's affairs." *Borders Group, 453 B.R. at 469*. To find that a person not listed in *§101(31)(B)* is an insider, the Borders Group court held, a court must determine that such a person has "at least a controlling interest in the debtor or . . . exercise[s] sufficient authority over the debtor so as to unqualifiably dictate corporate policy and the disposition of corporate assets." *453 B.R. at 469* (internal quotation marks and citation omitted). See also *In re Velo Holdings Inc., No. 12-11384, 472 B.R. 201, 2012 Bankr. LEXIS 2535, 2012 WL 2015870, at *5, (Bankr. S.D.N.Y. Jun. 06, 2012)* (applying the same test).

The record clearly establishes that the KERP Employees are not insiders as defined in *§ 101(31)(B)*. As an initial matter, none of the KERP Employees **[**12]** is a member of the board of the Debtors or participates in corporate governance. (Tr. 72:4-15.) They are not directors as that term is understood in the context of *§ 101(31)(B)*. Like the corporate employees in Borders Group, most of whom had the word "director" attached to their titles, the Directors of Safety, Maintenance and Operations have none of the responsibilities of a corporate director. None of the KERP Employees attend board meetings, and they generally do not report to the board. (Tr. 72:4-12.) Nor do the KERP Employees qualify as "officers" of the Debtors. The record is clear that the board did not appoint or elect the KERP Employees to the positions they hold. (Tr. 38:15-18.)

Nor are the KERP Employees "person[s] in control of the debtor" within the meaning of *§ 101(31)(B)(iii)*. The Debtors' pay scale has twenty-two different grades. Grade 1 through Grade 5 consist of the Debtors' senior executives. The pay grades of the KERP Employees fall below these top grades. (Tr. 71:1-10.) None of the KERP Employees receive equity of the Debtors as part

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[7] "Tr." refers to the transcript of the hearing held on July 11, 2012. Citations to the transcript are by page number and line.

of their compensation packages. Only the Director of Operations **[*149]** owns a small number of restricted shares issued by the Debtors. (Tr. **[**13]** 71:16-72:3.)

The organizational structure of North American places the KERP Employees at least two levels down from senior management. Four of the five KERP Employees report to the Chief Operating Officer of North American, who in turn reports to the Debtors' senior management team, including the Chief Executive Officer, the President, the Chief Commercial Officer, the Chief Financial Officer and the General Counsel. (Dec. at ¶ 10.) Additionally, the Chief Pilot reports to the Vice President, Flight Operations, who then reports to the Chief Operating Officer of North American. (Id.) The Director of Safety has the ability to report directly to the board on matters pertaining to safety, as required by FAA regulations. (Id.; Tr. 39:17-20.) However, he does not report to the board in the "ordinary course." (Tr. 148:24-25;149:1-3.) He generally reports to the Chief Operating Officer of North American. (Dec. at ¶ 10.) The Director of Safety is not an insider for purposes of *§ 101(31)(B)* solely because FAA regulations require him to report to the board on safety issues.

None of the KERP Employees have discretionary control over substantial budgetary amounts. Most of the items in the budgets **[**14]** for which the KERP Employees are responsible fall under the non-discretionary category of salaries for existing employees, which are payments over which the KERP Employees have no control. (Tr. 91:1-94:13; 139:15-140:7.) Although the Director of Maintenance has some discretion to expend funds for emergency repairs, this discretion is limited. (Tr. 94:14-96:1.) Mr. Garrett testified that, although the Director of Maintenance would have discretion to approve expenditures for day-to-day maintenance, larger expenditures would require supervisory approval. (Tr. 95:14-17.) ("[I]f he has to replace an engine he could not make that decision. He could make a recommendation whether we lease or buy. There's a huge financial analysis because of that.") Importantly, none of the KERP Employees had any role in the development of the KERP, nor did they have any authority to do so. (Tr. 96:6-16.)

The KERP Employees are tasked with writing and updating manuals required by the FAA for safety, maintenance and flight operations. This process consists of interpreting FAA guidelines for application to North American's operations, and those manuals must be approved by the FAA, and the Chief Operating Officer **[**15]** of North American. (Tr. 73:11-18; 88:23-89:7.) This work with respect to manuals does not constitute setting corporate policy for North American. It rather reflects responsibility for the "day-to-day operations" of the airline consistent with the status of mid-ranking non-insider employees. *Borders Group, 453 B.R at 469*.

HN5[] The legislative history of *§ 101(31)(B)* makes it clear that Congress was concerned with situations where "[a]n insider . . . has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor." *9281 Shore Road Owners Corp., 187 B.R. at 853* (quoting H.R.Rep. No. 595, 95th Cong., 1st Sess. 311-314 (1977)). In the context of enacting the limitations set forth in *§ 503(c)*, Congress was responding to an "inherently unseemly" public perception that chapter 11 bonus programs "ha[d] been used to lavishly reward-at the expense of the creditor body-the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight." *In re U.S. Airways, [*150] Inc., 329 B.R. 793, 797 (Bankr. E.D. Va. 2005)*.

Based on the record, it is clear that none of the KERP Employees **[**16]** have authority to make company-wide or strategic decisions. None of the KERP Employees "exercise[s] sufficient authority over the debtor as to unqualifiably dictate corporate policy and the disposition of corporate assets." *Borders Group, 453 B.R at 469*. Given their intermediate positions in the corporate chain of command, their distance from the board and senior management, and the limited extent of their corporate authority, it is apparent that none of the KERP Employees are insiders under *§ 101(31)(B)*.

B. Analysis under *§ 503(c)(3)*

Given that *§ 503(c)(1)* is inapplicable because the KERP Employees are not insiders, the KERP must be analyzed under *§ 503(c)(3)*, which governs bonus payments to employees that are outside of the ordinary course. Such payments are permitted only if they are "justified by the facts and circumstances of the case." *11 U.S.C. § 503(c)(3)*.

HN6[] The appropriate standard for determining whether an outside the ordinary course compensation proposal is justified by the facts and circumstances of a given case was articulated in *In re Dana Corp., 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006) ("Dana II")* as follows:

- whether the plan has a reasonable relationship to the results **[**17]** to be obtained;

- whether the cost is reasonable in light of the debtor's assets, liabilities, and earnings potential;
- whether the scope of the plan is fair and reasonable or discriminates unfairly;
- whether the plan comports with industry standards;
- whether the debtor undertook due diligence in investigating the need for a plan, the employees that should be incentivized, market standards; and
- whether the debtor received independent counsel in performing due diligence in creating and authorizing the incentive compensation.

Applying these factors to the KERP demonstrates that the proposed bonuses are justified by the facts and circumstances of this case.

1. *Relationship Between the KERP and the Results to be Obtained*

The Debtors have sufficiently demonstrated that a reasonable relationship exists between the KERP and the results the Debtors seek to obtain from it. The purpose of paying bonuses to the KERP Employees is to ensure that they remain with the Debtors until the FAA has approved the transfer of the operations of North American to Georgia. This is important because of the role the KERP Employees play in obtaining FAA approval of North American's relocation. The KERP Employees **[**18]** fill the five positions specifically mandated by FAA regulation *§ 119.65*, and oversee and manage the systems that must be approved by the FAA as a prerequisite to the relocation of North American's operations to Georgia. (Dec. at ¶ 5.) As a result, the KERP Employees have been working on the relocation as North American's "key liaisons to the FAA" since shortly after the Petition Date. (Supp. Dec. at ¶ 9.) Mr. Garrett testified that "[t]he FAA relies heavily on the relationship with the KERP [Employees] in determining approval of operational relocation." (Id. at ¶ 9.)

[*151] Moreover, Mr. Garrett testified that, given the specific qualifications set forth in FAA regulations for each of the five positions filled by the KERP Employees, hiring replacements would take "longer than a month," requiring the Debtors not only to find qualified applicants but to obtain FAA approval before the replacements may take their positions. (Tr. 76: 12-17.) Mr. Garrett further testified that, even after a replacement is hired, the "learning curve in this business is very large," and that it would take the replacement time to become familiar with North American's software programs and protocols. (Tr. 78: 9-12.) **[**19]** Mr. Garrett unequivocally testified that, if North American had to go through the process of hiring a replacement for one of the KERP Employees, the relocation to Georgia would be delayed beyond August 31, 2012. (Tr. 76: 23-77:1.) Given that the relocation of North American to Georgia is a key component of the Debtors' restructuring, and that the Debtors have demonstrated that the KERP Employees play a critical role in obtaining the FAA approval that is a prerequisite to this relocation, there is clearly a reasonable relationship between offering the KERP Employees a bonus and achieving a timely transfer of North American's operations to Georgia.

The Committee, however, argues that the bonuses are unnecessary, and therefore, unreasonable, because, as of the hearing date, the KERP Employees have already accepted positions with the Debtors in Georgia. The Committee asserts that the Motion should be denied because the Debtors have not presented any evidence that any of the KERP Employees intends to leave North American.

This argument has the effect of reading the requirements of *§ 503(c)(1)* into *§ 503(c)(3)*. Although the KERP proposes to pay retention bonuses, ***HN7***[↑] no showing of a bona fide **[**20]** job offer or any other evidence of an intent to leave is required to pay a bonus to non-insiders under *§ 503(c)(3)*. Moreover, the fact that the KERP Employees have agreed to remain in their positions does not lead to the conclusion that the proposed bonuses are unnecessary. The KERP Employees are at-will employees and their employment may be terminated at any time by either side for any reason. The "commitments" that the Committee refers to are in no way legally binding on the KERP Employees, and as Mr. Garrett testified, were made with the understanding that the Debtors would seek authorization to pay the bonuses in question. (Tr. 76: 5-6.) Mr. Garrett testified that North American has "been losing employees, important employees to our competitors," and that since the Petition Date, North American has lost 45% of its work force. (Tr. 75: 17-18; 22-23). See *Borders Group, 453 B.R. 474-75* ("The necessity for retaining and incentivizing important employees is especially pressing given the recent and numerically significant exodus of corporate employees."). It is reasonable for the Debtors to conclude, as they have, that there is a risk that at least one of the KERP Employees would, in **[**21]** the event the KERP was not approved, leave North American.

The Committee would have the Debtors make the gamble that all KERP Employees would elect to remain even if the bonuses were not paid. Mr. Garrett, however, testified that even one of the KERP Employees were to leave North American before the move, the requisite FAA approval, and hence the relocation, would be delayed beyond the August 31, 2012 target date. In that case, the Debtors would continue to incur the costs of operating North American out of JFK International Airport, which includes a monthly lease payment of $132,251. Given that the **[*152]** amount of one month's rent at JFK International Airport is approximately equal to the amount of the entire proposed bonus package, the Debtors are clearly justified in electing not to gamble on whether the KERP Employees would remain with North American without receiving these proposed bonuses.

2. *Cost of the KERP is Reasonable in Light of the Debtors' Finances*

The KERP is economically reasonable. In 2011, the Debtors reported revenue in excess of $1 billion. (Motion at ¶ 36.) The Debtors' proposed bonuses of $137,031 constitute less than 0.014 percent of their 2011 revenue.

The UST, in its **[**22]** objection, argues that the Debtors have failed to provide sufficient information regarding the economic reasonableness of the proposed bonuses. The UST further points out that the financial documents that have been provided show the Debtors operating at a loss in excess of $111 million since the Petition Date. (UST Objection at ¶ 47.)

The Debtors argue that the figure cited by the UST is not an accurate representation of the Debtors' current financial state because, as Mr. Garret testified, approximately $80 million of the $111 million loss represents write offs of maintenance deposits associated with leases that the Debtors have rejected, while another $9 million represents professional fees incurred in this bankruptcy case. (Tr. 99:6-10.) Mr. Garret testified that, putting the Debtors' reorganization expenses aside, the Debtors' operating figures since the Petition Date are far better: North American has operated at a $200,000 profit and World has operated at slightly over a $10 million loss. (Tr. 101: 9-11.)

Mr. Garrett testified that, in any event, a better indicator of the Debtors' financial condition is EBITDA,[8] which reflects the cash flow generated by the Debtors' operations. **[**23]** (Tr. 101: 17-21.) The Debtors' EBITDA is calculated by adding the Debtors' depreciation expenses, totaling approximately $23 million, to the approximate $10 million loss the Debtors have incurred since the Petition Date, which results in a positive cash flow of $13 million since the bankruptcy filing. (Tr. 101: 21-24.)

Ultimately, however, regardless of the method by which the Debtors' financial condition is assessed, the proposed bonuses are economically reasonable: the KERP is a small cost to ensure that the Debtors are able to begin achieving the significant costs savings associated with the relocation of North American to Georgia as soon as possible.

3. *The KERP Does Not Discriminate Unfairly*

The Debtors have shown that the KERP does not discriminate unfairly. ***HN8***[] Discrimination is permitted as long as it is fair because different employees may have different values to the debtor's reorganization efforts. *Borders Group, 453 B.R. at 475-476*. No unfair discrimination exists if the pool of bonus recipients is not limited to the most senior executives and is "broad enough" to include lower-ranking employees vital to **[**24]** the chapter 11 process. *Id. at 475* (quoting *In re EaglePicher Holdings, Inc., No. 05-12601, 2005 Bankr. LEXIS 2894, 2005 WL 4030132, at *4 (Bankr. S.D. Ohio Aug. 26, 2005)*).

The KERP excludes the senior executives of the Debtors and proposes to pay bonuses to a specific group of mid-ranking employees: those whose positions are mandated by the FAA. The Debtors have **[*153]** provided ample evidentiary support that the continued employment of the KERP Employees is "of paramount importance to the Debtors' reorganization effort." *Borders Group, 453 B.R. at 476*. If the KERP Employees elect not to stay with the Debtors, the relocation of North American and the resulting cost savings to the Debtors will inevitably be delayed. The fact that the Debtors considered but ultimately rejected the payment of bonuses to a larger group of employees (Tr. 136: 11-12.) further demonstrates that the Debtors have "carefully selected" the pool of bonus recipients. *Borders Group, 453 B.R. at 476*.

4. *The KERP Comports with Industry Standards*

No evidence was introduced of industry compensation practices, other than Mr. Garrett's testimony that the Debtors' compensation packages are at the low end of

[8] EBITDA is earnings before interest, taxes, depreciation, and amortization.

the industry spectrum. (Tr. 107:11-13.) ("[O]ur **[**25]** reputation in aviation-- and again this is just Bill Garrett's opinion, we generally pay low.")

However, the Velo Holdings court upheld a bonus program as consistent with industry practices because it was "nearly identical to the bonus plan that the Debtors had in place prepetition." *Velo Holdings, 2012 Bankr. LEXIS 2535, 2012 WL 2015870 at *9*. The Borders Group court also approved a bonus program that was modeled after a prepetition bonus program. *453 B.R. at 464-65*. Here too, the proposed bonus payments equal to the amounts that the KERP Employees would have received under the Debtors' pre-petition bonus program, and thus this *Dana II* factor is satisfied.

5. *The Debtors Have Exercised Due Diligence*

The record demonstrates that the Debtors performed sufficient due diligence in investigating the need for a retention bonus plan and in determining the specific employees that should be eligible for a bonus. ***HN9***[] This Court held in *In re Brooklyn Hosp. Center, 341 B.R. 405, 412 (Bankr. E.D.N.Y. 2006)*, that due care was exercised where "[t]he board consulted with its counsel and financial advisors, formulated several proposals, reduced the amount to be paid pursuant to [a bonus program], and, after negotiations with the **[**26]** Committee, broadened the scope of employees included and added a mitigation clause to the severance payment provision." Likewise, in Borders Group, the debtor relied on the expert input of a third-party consultant. *453 B.R. at 477*.

Here, the Debtors worked with a compensation consultant, Towers Barrett, in devising the KERP. (Tr. 158:2-8.) The Debtors' senior management team originally considered a much wider pool of potential bonus recipients and ultimately narrowed the field to the five KERP Employees who are critical to the timely relocation of North American. (Tr. 136:11-12.) ("It was a management decision not to go forth with" a wider bonus program). Accordingly, the Debtors have demonstrated the requisite level of due diligence.

6. *The Debtors Have Received Sufficient Counsel*

HN10[] The sixth Dana II factor deals with whether a debtor received independent counsel in performing due diligence and in authorizing a retention bonus. However, the lack of counsel "is not fatal." *Borders Group, 453 B.R. at 477*.

The bonus program at issue in Borders Group was not reviewed by independent counsel, but it still passed muster because of the participation of a third party consultant as well as the existence **[**27]** of a pre-petition bonus program upon which the proposed bonus payments were based. Id. Likewise, the Debtors here had the benefit **[*154]** of advice from a compensation consultant and the bonus payments to be made to the KERP Employees "are commensurate with," id., what they would have received under a company-wide bonus program that was in existence for at least five years prior to the Petition Date. (Tr. 106:21-24.) ("[The] basis of this program is the bonus plan that's been in place at the airline since I've been working there. So at least five years. It's the incentive program that we utilize to incent all our employees.")

Moreover, the Debtors consulted with its bankruptcy counsel in connection with the bonus program. (Tr. 41:13-16) ("The company worked with its lawyers and its advisors and with the first lien lenders and the DIP lenders to make sure that this was a plan that major constituencies did approve.") Finally, the relatively modest size of the proposed bonus payouts made the retention of independent legal counsel economically inefficient. Like the Borders Group court, this Court "is satisfied that Debtors' interests were sufficiently protected" under the sixth Dana II factor. *Borders Group, 453 B.R. at 477*.

CONCLUSION

For **[**28]** the reasons set forth above, the KERP Employees are not insiders of the Debtors, and the proposed bonuses to the KERP Employees are justified by the facts and circumstances of this case. Accordingly, the Motion is granted. A separate order will issue.

Dated: Brooklyn, New York

July 24, 2012

/s/ Carla E. Craig

Carla E. Craig

United States Bankruptcy Judge

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In re Hawker Beechcraft, Inc.

United States Bankruptcy Court for the Southern District of New York

August 24, 2012, Decided

Chapter 11, Case No.: 12-11873 (SMB)

Reporter

479 B.R. 308 *; 2012 Bankr. LEXIS 3899 **; 68 Collier Bankr. Cas. 2d (MB) 510; 56 Bankr. Ct. Dec. 259; 2012 WL 3637251

In re: HAWKER BEECHCRAFT, INC., et al., Debtors.

Core Terms

targets, consummate, bonus, incentive plan, retention, insiders, earn, key employee, bonuses, base salary, reductions, Approving, deadline, billion, confirm, purchase price, business plan, projections, executives, services, senior, Exclusivity, employees, includes, parties, circumstances, pre-petition, requirements, challenging, cumulative

Case Summary

Procedural Posture

Debtors filed a motion seeking approval of their proposed key employee incentive plan (the "KEIP") and their non-insider key employee retention plan (the "KERP"). Following an evidentiary hearing, the court approved the KERP from the bench, and reserved decision on the KEIP.

Overview

Debtors conceded that the members of the senior leadership team (SLT) were "insiders," and accordingly, the threshold question raised by the objections to the Motion was whether the KEIP was a true incentive plan, or instead, a disguised retention plan. 11 U.S.C.S. § 503(c)(1) of the Bankruptcy Code governed retention plans applicable to insiders. Congress enacted § 503(c) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amendments to the Bankruptcy Code to eradicate the notion that executives were entitled to bonuses simply for staying with a company through the bankruptcy process. The court stated that the BAPCPA changes imposed a high standard that required challenging goals that insiders had to meet in order to earn a bonus under an incentive plan that was not subject to § 503(c)(1). Debtors failed to sustain their burden of proof. The targets at the higher end of the KEIP met this requirement but the goals at the lower end did not. Because the SLT members would likely earn some bonus under the KEIP merely by remaining with debtors and regardless of the road debtors took, approval of the KEIP had to be denied.

Outcome

The court denied the KEIP part of the Motion without prejudice.

LexisNexis® Headnotes

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN1[] Reorganizations, Key Employee Retention Plans

11 U.S.C.S. § 503(c)(1) of the Bankruptcy Code governs retention plans applicable to insiders.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN2[] Reorganizations, Key Employee Retention Plans

See 11 U.S.C.S. § 503(c)(1).

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

HN3[] Reorganizations, Key Employee Retention

Plans

A debtor is, of course, free to propose a key employee retention plan (KERP) for the benefit of insiders that satisfies the rigorous criteria in _11 U.S.C.S. § 503(c)(1)_. Furthermore, _§ 503(c)(1)_ does not prevent a debtor from adopting a plan that rewards insiders for achieving financial or other targets, rather than for simply remaining in the employment of the debtor, even though the incentive plan has a retentive effect. A concern is that a debtor has dressed up a KERP to look like a key employee incentive plan (KEIP) in the hope that it will pass muster under the less demanding "facts and circumstances" standard in _§ 503(c)(3)_. Courts must be wary of attempts to characterize what is essentially an insider retention plan as an "incentive" plan to bypass the requirements of _§ 503(c)(1)_ and should consider the circumstances under which particular proposals are made, along with the structure of the compensation packages, when determining whether the compensation programs are subject to _§ 503(c)(1)_.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

Evidence > Burdens of Proof > Allocation

_HN4_[] **Reorganizations, Key Employee Retention Plans**

A court must examine a proposed key employee incentive plan (KEIP) mindful of the practice that Congress sought to eradicate and, at the risk of oversimplification, determine whether the proposed targets are designed to motivate insiders to rise to a challenge or merely report to work. The effect of _11 U.S.C.S. § 503(c)_ was to put in place a set of challenging standards and high hurdles for debtors to overcome before retention bonuses could be paid. The proponent of the KEIP bears the burden of proving that the plan is not a retention plan governed by _§ 503(c)(1)_.

Bankruptcy Law > Reorganizations > Key Employee Retention Plans

_HN5_[] **Reorganizations, Key Employee Retention Plans**

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 changes impose a high standard that requires challenging goals that insiders must meet in order to earn a bonus under an incentive plan that is not subject to _11 U.S.C.S. § 503(c)(1)_.

Counsel: **[**1]** For the Debtors and Debtors in Possession: James H.M. Sprayregen, Esq., Paul M. Basta, Esq., Patrick J. Nash, Jr., Esq., Ross M. Kwasteniet, Esq., Of Counsel, KIRKLAND & ELLIS LLP, New York, NY.

United States Trustee: Paul K. Schwartzberg, Esq., Of Counsel, TRACY HOPE DAVIS, New York, New York.

For the International Association of Machinists and Aerospace Workers, AFL-CIO: Sharon L. Levine, Esq., Paul Kizel, Esq., Of Counsel, LOWENSTEIN SANDLER PC, Roseland, NJ.

Judges: STUART M. BERNSTEIN, United States Bankruptcy Judge.

Opinion by: STUART M. BERNSTEIN

Opinion

[*309] MEMORANDUM DECISION DENYING DEBTORS' MOTION TO IMPLEMENT A KEY EMPLOYEE INCENTIVE PLAN

STUART M. BERNSTEIN

UNITED STATES BANKRUPTCY JUDGE:

The Debtors filed a motion seeking approval of their proposed key employee incentive plan (the "KEIP") and their non-insider key employee retention plan (the "KERP"). (*See Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan and Key Employee Retention Plan and Granting Related Relief*, dated on July 13, 2012 ("*Motion*") (ECF Doc. # 349).) Following an evidentiary hearing, the Court approved the KERP from the bench, and reserved decision on the KEIP. Although the KEIP includes elements of incentive **[**2]** compensation, when viewed as a whole, it sets the minimum bonus bar too low to qualify as anything other than a retention program for insiders. Accordingly, the Court concludes that the Debtors have failed to sustain their burden of proof and denies the KEIP part of the *Motion* without prejudice.

BACKGROUND

A. Introduction

At all relevant times, the Debtors have been engaged in the business of manufacturing and servicing business jets, trainer/attack aircraft and propeller and piston aircraft under the Hawker and Beechcraft brands. (*See Declaration of Robert S. Miller (I) In Support of the Debtors' Chapter 11 Petitions and First Day Motions and (II) Pursuant to Local Bankruptcy Rule 1007-2*, dated May 4, 2012, at ¶¶ 6, 13 ("*Miller First Day Declaration*") (ECF Doc. # 22).) Burdened with excessive secured and unsecured debt, they filed chapter 11 petitions in this Court on May 3, 2012 (the "Petition Date"). (*Motion* at ¶ 4.)

Prior to the Petition Date, the Debtors had entered into a Restructuring Support Agreement (the "RSA")[1] with the majority of their creditors (the "Consenting Creditors") which, in substance, would convert 100% of their prepetition debt into equity (the "Standalone Transaction"). **[**3]** The Debtors also agreed prior to the Petition Date but in contemplation of bankruptcy to (a) file a plan of reorganization and disclosure statement by June 30, 2012, (b) obtain an order approving the disclosure statement by August 31, 2012, (c) confirm the plan by November 15, 2012 and (d) consummate the plan by December 15, 2012. (*Miller First Day Declaration* at ¶ 60.) The Debtors met the first deadline, and scheduled the hearing to approve their disclosure statement for August 30, 2012. The latter hearing (and presumably, the August 31 deadline) has been adjourned, on consent, to September 27, 2012.

The RSA did not preclude the Debtors and their advisors from engaging in a marketing **[*310]** process to pursue a sale or other strategic transaction with a third party ("Third-Party Transaction"). (*See* RSA at § 11.) The Debtors proceeded on a dual track pursuing the plan contemplated by the Standalone Transaction (the "Standalone Plan") while contemporaneously seeking a Third-Party Transaction that would provide greater value to the estates. (*See* Transcript of the hearing held July 26, 2012 ("*7/26 Tr.*") at 31:3-32:10 **[**4]** (ECF Doc. #432).) On or about July 2, 2012, the Debtors received a Second Revised Proposal from Superior Aviation Beijing, Co., Ltd. ("Superior") to purchase substantially all of the Debtors' assets (excluding its defense business) on a cash free, debt-free basis for $1.79 billion in cash (the "Superior Proposal").[2] The Superior Proposal was subject to several conditions including a 45 day exclusive access period during which the Debtors would cease soliciting or negotiating with other third parties, the parties would execute a definitive agreement, the Debtors would hold a bankruptcy auction and the parties would obtain the necessary regulatory approvals.[3]

On July 10, 2012, the Debtors filed the *Superior Exclusivity Motion* **[**5]** which sought Court authorization to grant the 45 day exclusivity sought by Superior. Following an evidentiary hearing, the Court granted the *Superior Exclusivity Motion* over the objection of the International Associations of Machinists and Aerospace Workers, AFL-CIO ("IAM"), the union that represented 45% of the Debtors' workforce as of the Petition Date. (*Miller First Day Declaration* at ¶¶ 6, 21.)

B. The *Motion*

The Debtors historically maintained incentive plans that paid certain key employees additional compensation through an annual cash incentive program based on certain cash and percentage profit targets and through equity-based awards. (*Declaration of Robert S. Miller in Support of the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan and the Key Employee Retention Plan and Granting Related Relief*, dated July 13, 2012 ("*Miller KEIP Declaration*"),[4] at ¶ 11; *see 7/26 Tr.* at 25.) The Debtors did not pay any bonuses to senior management under the 2011 plan because it failed to meet its targets. (*7/26 Tr.* at 54.) There is also the structure for an incentive program in place for 2012, but the objectives have not been developed due to the instability **[**6]** in the business. (*Id.* at 26.)

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[1] A copy of the RSA is annexed as Exhibit A to the *Miller First Day Declaration*.

[2] A copy of the Superior Proposal is attached as Exhibit C to the *Debtors' Motion for the Entry of an Order Authorizing the Debtors to Enter into an Exclusive Negotiations Agreement and a Refund Agreement*, dated July 10, 2012) ("*Superior Exclusivity Motion*") (ECF Doc. # 324).

[3] Among other things, a sale to Superior, a Chinese entity that is partially owned by the City of Beijing, will require the approval of the Committee on Foreign Investment in the United States.

[4] A copy of the *Miller KEIP Declaration* is annexed to the *Motion* as Exhibit B.

As they contemplated bankruptcy, the Debtors opted to develop a senior management incentive program, and retained Towers Watson, executive compensation experts, to assist in its development. According to the testimony of Nick Bubnovich, a former director of Towers Watson who testified as an expert, the Debtors' senior management's base salary stood at 58% below the market median, (*id.* at 78), substantially below market. (*Id.* at 84.) Working in conjunction with the Official Committee of Unsecured Creditors (the "Committee") and the Consenting Creditors, the Debtors' developed the KEIP and **[*311]** filed the *Motion* seeking its approval.[5]

The KEIP applies to eight "insiders" within the meaning of *11 U.S.C. § 101(31)*, denominated as the senior leadership team, or SLT. They include the Debtors' Chairman, the Executive Vice President of Operations, the Vice President of Human Resources, the Vice President of Engineering, the Executive Vice President and General Counsel, the Senior Vice President of Global **[**7]** Customer Support, the Chief Financial Officer and the Executive Vice President of Customers. (*Motion* at ¶ 18.) The KEIP offers two mutually exclusive paths for awarding bonuses to the SLT depending on whether the Debtors consummate the Standalone Plan or a Third-Party Transaction. To be eligible to receive payment of any award, the SLT member must be employed on the effective date of the plan unless the SLT member has been terminated without cause or resigned for good reason prior to the date that payment is due. (*Id.* at ¶¶ 27, 30.)

1. The Standalone Plan

Each member of the SLT can earn up to 200% of his annual base salary, or the aggregate amount of $5,328,000, in the event the Debtors' consummate the Standalone Plan (the "Standalone Transaction Award"). The award is comprised of two independent components with 50% based on the timing of the consummation (the "Consummation Award") and 50% based on the achievement of financial targets (the "Financial Performance Award"). The Consummation Award provides for a sliding scale of recovery under which the SLT members can earn a bonus if the Debtors consummate the Standalone Plan on or before December 15, 2012. The earlier the consummation, **[**8]** the greater the award. The following table, taken from the Motion, illustrates the target dates, and the percentage of base salary and total payouts under the Consummation Award:

(*Id.* at ¶ 21.) These dates can be extended without notice or Court approval at the discretion of the Debtors and with the agreement of the Consenting Creditors and the Committee. (*Id.*) In addition, the target consummation dates will automatically be extended by the number of days (but not to exceed 30 days) beyond August 31, 2012, in which the Debtors have not resolved the treatment of their three defined benefit pension plans. (*Id.*)

The second component of the Standalone Transaction Award is the Financial Performance Award. The computation of this award is set out in a complicated chart at paragraph 23 of the Motion; it is based on a sliding scale of targets relating to the Debtors' cumulative net cash flow starting on July 9, 2012, and ending as of the end of the week in which the plan is consummated. The lowest target level, which pays 50% of the base salary to each member **[*312]** of the SLT, corresponds to the projections under the Debtors' business plan. (*7/26 Tr.* at 66.)

2. Third-Party Transaction

The KEIP includes **[**9]** a separate set of incentives if the Debtors consummate a plan based on a Third-Party Transaction. Each member of the SLT would receive a sale bonus of 200% of his base salary upon Court approval of a Third-Party Transaction prior to December 15, 2012 that (a) results in a purchase price of at least $1.79 billion and (b) closes no later than January 15, 2013 (the "Third-Party Transaction Award"). (*Motion* at ¶ 29.) As with the Consummation Award, these dates can be extended with the consent of the Committee and the Consenting Creditors. (*Id.* at ¶ 29 n.10.) If the Court-approved Third-Party Transaction results in a purchase price of less than $1.79 billion, the Third-Party Transaction Award would decrease by 25% of each SLT member's base salary for each $100 million in purchase price below $1.79 billion. However, there would not be any downward adjustment if (a) the decrease in purchase price is the result of a purchase price adjustment triggered by the assumption of certain liabilities (which is not currently contemplated) and (b) the assumption of such liabilities is supported by the Committee. (*Id.*) In the event the Debtors determine to pursue the Third-Party Transaction, but through

[5] The *Motion* also sought approval of the KERP. As noted, the latter was approved from the bench.

[10]** no fault of management, the Third-Party Transaction does not close, the Debtors will award the Standalone Transaction Awards, but the level of cumulative net cash flow that needs to be reached for 50% of the bonus will be adjusted to reflect the costs expected to be incurred while the Debtors pursue the Third-Party Transaction. (*Id.* at ¶ 31.)

DISCUSSION

The Debtors concede that the members of the SLT are "insiders," and accordingly, the threshold question raised by the objections to the Motion is whether the KEIP is a true incentive plan, or instead, a disguised retention plan. ***HN1***[🡅] Section 503(c)(1) of the Bankruptcy Code governs retention plans applicable to insiders.[6] Congress enacted § 503(c) as part of the 2005 BAPCPA amendments to the Bankruptcy Code to "eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the **[*313]** bankruptcy process," *In re Global Home Prods., LLC, 369 B.R. 778, 784 (Bankr. D. Del. 2007)* (internal quotation marks omitted); *accord In re Velo Holdings Inc., 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012)*, and to "limit the scope of 'key employee retention plans' and other programs providing incentives to management of the debtor **[**11]** as a means of inducing management to remain employed by the debtor." 4 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 503.17, at 503-105 (16th ed. 2012).

HN3[🡅] A debtor is, of course, free to propose a KERP for the benefit of insiders that satisfies the rigorous criteria in *§ 503(c)(1)*. Furthermore, *§ 503(c)(1)* does not prevent a debtor from adopting a plan that rewards insiders for achieving financial or other targets, rather than for simply remaining in the employment of the debtor, even though the incentive plan has a retentive effect. *See In re Dana Corp., 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006)* ("*Dana I*"). The concern in the type of motion presented in this case is that the debtor has dressed up a KERP to look like a KEIP in the hope that it will pass muster under the less demanding "facts and circumstances" standard in *11 U.S.C. § 503(c)(3)*. *Velo Holdings, 472 B.R. at 209* (reasoning that courts must be wary of attempts to characterize **[**13]** what is essentially an insider retention plan as an "incentive" plan "to bypass the requirements of *section 503(c)(1)*" and should "consider the circumstances under which particular proposals are made, along with the structure of the compensation packages, when determining whether the compensation programs are subject to *section 503(c)(1)*"); *see Dana I, 351 B.R. at 102 n.3* ("If [a bonus proposal] walks like a duck (KERP), and quacks like a duck (KERP), it's a duck (KERP)."). ***HN4***[🡅] The Court must examine a proposed KEIP mindful of the practice that Congress sought to eradicate and, at the risk of oversimplification, determine whether the proposed targets are designed to motivate insiders to rise to a challenge or merely report to work. *See Velo Holdings, 472 B.R. at 209* ("The effect of *section 503(c)* was to put in place 'a set of challenging standards' and 'high hurdles' for debtors to overcome before retention bonuses could be paid."); *In re Mesa Air Group, Inc., No. 10-10018 (MG), 2010 Bankr. LEXIS 3334, 2010 WL 3810899, at *2 (Bankr. S.D.N.Y. 2010)* (same); *Global Home, 369 B.R. at 784-85* (same). The proponent of the

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[6] *Section 503(c)(1)* provides:

> ***HN2***[🡅] (c) Notwithstanding subsection (b), there shall neither be allowed, nor paid—
>
> (1) 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, absent a finding by the court based on evidence in the record that—
>
> (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
>
> (B) the services provided by the person are essential to the survival of the business; and
>
> (C) either--
>
> > (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
> >
> > (ii) if no such similar transfers were made to, or obligations **[**12]** were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred; . . . .

KEIP bears the burden of proving that the plan is not a retention plan governed by § 503(c)(1). [**14] *See* Mesa Air Group, No. 10-10018 (MG), 2010 Bankr. LEXIS 3334, 2010 WL 3810899, at * 3.

Here, the Debtors have failed to sustain their burden of proof. At the outset, they did not identify the roles of each member of the SLT or why, individually or as part of a team, they will contribute services that are necessary to achieve the targets. Beyond that, although the KEIP includes incentivizing targets, the lowest levels are well within reach.[7] The SLT will earn a bonus under either of two transactions one of which is bound to occur. The Debtors are on target to meet the confirmation and consummation deadlines under the RSA and KEIP pertaining to the Standalone Transaction, but in any event, the deadlines under each alternative can be extended with the consent of the parties.

Each alternative includes a financial target (cumulative net cash flow or sale price), but the Debtors do not have to hit any financial target to pay a bonus under **[*314]** the Standalone Transaction,[8] and the sale price target does not seem to be much of a challenge in **[**15]** light of the Superior Proposal and the fact that the Debtors must still pay a bonus even if a Third-Party Transaction is consummated at a substantially reduced price.[9] In essence, the KEIP pays a bonus for consummating a plan that is likely to occur, and closely resembles the KERP rejected in *Dana I*. *See* Dana I, 351 B.R. at 102 (refusing to approve incentive plan that paid a completion bonus even if the debtors' total enterprise value declined).

Furthermore, the SLT member does not earn a bonus if the member quits prior to consummation of the transaction (the effective date of a plan). Thus, if the SLT member does everything required of him and more, but the effective date is delayed because of an appeal, and the SLT member takes another job in the interim, he sacrifices his bonus. In other words, he has to stay for his pay.

Finally, the Debtors' Chief Executive Officer Robert S. Miller confirmed the retentive purpose of the Third-Party Transaction Award. He opined that in its absence, "the SLT could seek alternative employment opportunities and, as a result, immediately undermine **[**17]** the Debtors' restructuring efforts at a critical juncture of the Debtors' chapter 11 cases and in the Debtors' business cycle." (*Miller KEIP Declaration* at ¶ 30.)

The Debtors' authorities do not support a contrary conclusion. In *In re Borders Group, 453 B.R. 459 (Bankr. S.D.N.Y. 2011)*, the debtors proposed a KEIP for the benefit of insiders that required them to confirm an ongoing (non-liquidating) business plan or consummate a sale of the business as a going concern under 11 U.S.C. § 363 *and* meet specific financial targets relating to annual rent reductions or other cost reductions as well as distributions to unsecured creditors. No bonuses would be paid in the event of a liquidation or going-out-of-business sales at the majority of the debtors' stores, the confirmation of a non-consensual plan, or the approval of a sale over the Committee's objection. *Id. at 465-66*. The Court approved a KEIP because the financial milestones and accomplishment of a qualifying transaction were both required, the debtors had to achieve rent reductions or other cost reductions, and the type of qualifying transaction was limited to one that continued the business in one form or another. *Id. at 471-72*. **[**18]** In this case, the SLT can earn a 50% bonus if the Debtors confirm and consummate the Standalone Plan by the dates agreed to under the RSA which are subject to extension, **[*315]** even if the Debtors' miss their financial targets. Furthermore, the sales price target

[7] The Debtors are fond of basketball analogies and argue that the targets are not "lay-ups." That may be so, but they are more like free throws than half court flings at the buzzer.

[8] The SLT member can earn an additional 50% bonus if the Debtors achieve the cash flow targets that are identical to their business plan projections, and can be met if the Debtors don't encounter any "whoopsies." (*7/26 Tr.* at 60.) The Debtors' witnesses ticked off numerous uncertainties on the income and expense sides, (*id.* at 67-69), but uncertainty is inherent in every prediction, and I assume that they were taken into account when the predictions were made by the Debtors' sophisticated financial employees and professionals. Furthermore, the Debtors cited the cost of carving out the defense business as one uncertain cost, (*id.* at 43, 69), but this expense will only be incurred in connection with the Third-Party Transaction and should be entirely **[**16]** irrelevant to the Financial Performance Award. Moreover, the Debtors did not offer evidence whether or not they were on target to achieve their projections.

[9] The 200% bonus will be reduced by 25% for every $100 million below the $1.79 billion Superior offer at which a Third-Party Transaction is consummated. In addition, the bonus reduction will be prorated to the extent that the price falls between two $100 million increments. Thus, if the Debtors consummate a Third-Party Transaction for as low as $1 billion, the SLT members will still earn a bonus.

under the Third-Party Transaction that must be met to earn some bonus is hardly challenging.

In *In re Dana Corp., 358 B.R. 567 (Bankr. S.D.N.Y. 2006)* ("*Dana II*"), the Court approved a long term incentive plan that awarded bonuses if the company reached a specific EBITDAR, and the bonuses increased as EBITDAR increased. The plan represented substantial reductions from the long-term incentive plans that were available pre-petition. *Id. at 574*. The Court approved the incentive plan based upon evidence showing that the debtors' pro forma EBITDAR was $210 million, and achieving the financial target of $250 million was difficult and not a "lay-up." *Id. at 583*. Here, the minimum target level matches the business plan projections, the Debtors' Chief Executive Officer testified that they should hit at least the minimum target if they don't encounter any "whoopsies," and the Debtors failed to compare their pre-petition plans to the KEIP.

Velo **[**19]** *Holdings* is more apposite but still distinguishable. There, the debtors proposed an incentive plan that included net operating cash flow targets based on the DIP budget. The pool applied to three executives and consisted of $600,000. In addition, the executives had to provide additional transitional services. *Velo Holdings, 472 B.R. at 205-06*. Although the Court approved the use of financial targets that were the same as those set forth in the debtors' business plan, it also cited to the fact that the KEIP required the executives "to *do more* to meet the wide-scale goals outlined in the KEIP as they must address concerns and issues that are unique to the bankruptcy proceeding. The KEIP encourages the Executive Employees to increase their pre-bankruptcy job responsibilities to achieve the bonus requirements and financial targets." *Id. at 210. (Emphasis in original.)*

In the same vein, the proposed KEIP in this case keys the minimum 50% Financial Performance Award under the Standalone Plan to the business projections. In addition, the Debtors offered general testimony that the SLT members will be required to provide the services necessary to move down dual plan paths. (*7/26 Tr.* at 26, 29-30.) **[**20]** To that extent, *Velo Holdings* is analogous. However, the SLT members can earn a 50% Consummation Award through the Standalone Plan under an indefinite deadline without meeting any financial targets. In addition, they can earn a 200% bonus under the Third-Party Transaction by consummating the transaction under a flexible deadline at a price that Superior has already offered, or a lesser bonus at a substantially lower price.[10]

Nothing in this opinion is meant to denigrate the efforts of the SLT or minimize their contributions to the success of the case. Nevertheless, ***HN5***[] the BAPCPA changes impose a high standard that requires challenging goals that insiders must meet in order to earn a bonus under an incentive plan that is not subject to *§ 503(c)(1)*. The targets at the higher end of the KEIP meet this requirement but the goals at the lower end do not. Because the SLT members will likely earn some bonus under the KEIP merely by remaining with the Debtors and **[**21]** regardless of the road the Debtors take, approval of the KEIP must be denied. In light of this conclusion, I do not decide whether the KEIP is an appropriate exercise of business judgment or satisfies **[*316]** the "facts and circumstances" test imposed under *§ 503(c)(3)*.

The foregoing constitutes the Court's findings of fact and conclusions of law. Submit order.

Dated: New York, New York

August 24, 2012

/s/ Stuart M. Bernstein

STUART M. BERNSTEIN

United States Bankruptcy Judge

End of Document

[10] The Debtors also cite to snippets of hearing transcripts or orders entered in other cases. (*See Debtors' Proposed Findings of Fact and Conclusions of Law,* dated Aug. 6, 2012 (ECF Doc. # 457).) I do not consider these to be persuasive.

Caution
As of: March 27, 2019 4:09 PM Z

In re Dana Corp.

United States Bankruptcy Court for the Southern District of New York

November 30, 2006, Decided

Chapter 11, Case No. 06-10354 (BRL), (Jointly Administered)

Reporter

358 B.R. 567 *; 2006 Bankr. LEXIS 3387 **; Bankr. L. Rep. (CCH) P80,803; 47 Bankr. Ct. Dec. 126

In re: Dana Corporation, et al., Debtors,

Core Terms

senior executive, employees, salary, pension benefits, Executives', benefits, employment agreement, incentive plan, termination, business judgment, retentive, severance, retirees, bonus, reorganization, companies, approve, terms, key employee, Post-Emergence, short-term, Senior, trucks, compensation package, ordinary course, unsecured claim, pension plan, eligible, bonuses, cases

Case Summary

Procedural Posture

Debtor corporation moved for an order authorizing its assumption of pre-petition employment agreements for its chief executive officer, and senior executives of its core management team, as modified, and approving a long-term performance based incentive plan for the purpose of retaining those employees, under a key employee retention plan.

Overview

Related corporate debtors were leading suppliers of modules, systems and components for original equipment manufacturers and service customers in the light, commercial, and off-highway vehicle markets. Debtors asserted, and their committees agreed, that the motion was a true incentivizing package for senior management, and thus did not violate the standards of *11 U.S.C.S. § 503(c)*, and the plan was within the fair and reasonable business judgment of the debtors. Proposed severance pay was in an amount that complied with *11 U.S.C.S. § 503(c)(2)*, and any other payments were non-severance in nature. The unions, non-union retiree committee and the U.S. Trustee objected to the assumption of the employment agreements. However, the court found that a short-term incentive plan was a common component of compensation plans of debtors for the past fifty years and did not differ significantly from the pre-petition practice, and thus was within the ordinary course of debtors' business. The court did impose a requirement for an appropriate ceiling on the total level of yearly compensation.

Outcome

The motion to allow executive compensation was granted, conditioned on the submission of an order including an appropriate ceiling or cap on the total level of yearly compensation to be earned by the chief executive officer and senior executives during the course of the bankruptcy proceedings.

LexisNexis® Headnotes

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN1[] **Administrative Expenses, Estate Preservation**

Generally, courts take a holistic view of and measure acceptability of compensation packages through the prism of several factors including: whether the amount of cost or expense is reasonable and in the best interest of the estate; whether the services to be provided are likely to enhance a successful reorganization or liquidation of the debtor; whether the debtor exercised appropriate business judgment in implementing any application for continuing, resuming, or retaining the executive.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN2[] Administrative Expenses, Estate Preservation

A true incentive plan may not be constrained by 11 U.S.C.S. § 503(c) limitations.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN3[] Administrative Expenses, Estate Preservation

11 U.S.C.S. § 503(c) restricts transfers or payments by debtors to the extent that such payments are outside the ordinary course. The predominate focus of the amendments to § 503(c) is on payments made to "insiders" of the debtor(s). However, § 503(c) was not intended to foreclose a Chapter 11 debtor from reasonably compensating employees, including insiders, for their contribution to the debtors' reorganization.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN4[] Administrative Expenses, Estate Preservation

11 U.S.C.S. § 503(c)(1) prohibits the allowance and payment of sums to "insiders" for the purpose of inducing such person to remain with the business absent a finding by the court based on the evidence in the record that (1) the payment is essential to the retention of the individual because the individual has a bona fide job offer from another business at the same or greater rate of compensation; and (2) the services of that individual are essential to the survival of the debtor's business. The statute also fixes the measure of acceptable retention bonuses for insiders by linking them to a multiple of bonuses available to non-management employees.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN5[] Administrative Expenses, Estate Preservation

11 U.S.C.S. § 503(c)(2) allows severance payments to be made to insiders only if they are part of a generally applicable program and are less than ten times the amount of the mean severance pay given to non-management employees. Under the law of the Second Circuit, "severance" is defined as a form of compensation for the termination of the employment relation, for reasons other than the displaced employees' misconduct, primarily to alleviate the consequent need for economic readjustment but also to recompense him for certain losses attributable to the dismissal.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN6[] Administrative Expenses, Estate Preservation

If 11 U.S.C.S. § 503(c)(1) and (c)(2) are not operative, a court may consider whether key employee retention payments are permissible under 11 U.S.C.S. § 503(c)(3), which limits payments made to management and employees, among others, outside of the ordinary course, unless such payments are shown to be justified under the facts and circumstances of the Chapter 11 case.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN7[] Administrative Expenses, Estate Preservation

11 U.S.C.S. § 503(c)(3) gives the court discretion as to bonus and incentive plans, which are not primarily motivated by retention or in the nature of severance.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

Business & Corporate Law > ... > Directors & Officers > Compensation > Bonuses & Severance Pay

HN8[] Administrative Expenses, Estate Preservation

In determining if the structure of a compensation proposal and the process for developing the proposal meet the sound business judgment test, a bankruptcy court considers whether there is a reasonable relationship between the plan proposed and the results to be obtained, that is, will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, is the plan calculated to achieve the desired performance. Whether the cost of the plan is reasonable in the context of the debtor's assets, liabilities and earning potential. Whether the scope of the plan is fair and reasonable; does it apply to all employees; does it discriminate unfairly. Whether the plan or proposal is consistent with industry standards. What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry. Whether the debtor received independent counsel in performing due diligence and in creating and authorizing the incentive compensation.

Governments > Legislation > Interpretation

HN9[] Legislation, Interpretation

Where a statute's language is plain, the sole function of the courts, at least where the disposition of the statute's text is not absurd, is to enforce the statute according to its terms.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > Estate Preservation

HN10[] Administrative Expenses, Estate Preservation

The language of 11 U.S.C.S. § 503(c) is clear and unambiguous that only administrative claims are subject to § 503(c) restrictions.

Bankruptcy Law > ... > Administrative Powers > Estate Property Lease, Sale & Use > Ordinary Course of Business

Bankruptcy Law > ... > Reorganizations > Debtors in Possession > Powers & Rights

HN11[] Estate Property Lease, Sale & Use, Ordinary Course of Business

The Bankruptcy Code is designed to allow a debtor-in-possession the flexibility to engage in ordinary transactions without unneeded oversight by creditors or the court, while at the same time giving creditors an opportunity to contest those transactions that are not ordinary.

Bankruptcy Law > ... > Administrative Powers > Estate Property Lease, Sale & Use > Ordinary Course of Business

HN12[] Estate Property Lease, Sale & Use, Ordinary Course of Business

See 11 U.S.C.S. § 363(c)(1).

Bankruptcy Law > ... > Administrative Powers > Estate Property Lease, Sale & Use > Ordinary Course of Business

HN13[] Estate Property Lease, Sale & Use, Ordinary Course of Business

The Bankruptcy Code does not provide guidance as to whether a particular transaction was conducted in the ordinary course of business but courts have applied a two-step horizontal and vertical test that considers the reasonableness of the transaction from an industry-wide perspective and from the viewpoint of a creditor: The inquiry deemed horizontal is whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry. The inquiry deemed vertical analyzes the transactions from the vantage point of a hypothetical creditor and the inquiry is whether the transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided to extend credit.

Bankruptcy Law > Administrative Powers > Executory Contracts & Unexpired Leases > General Overview

HN14[] Administrative Powers, Executory Contracts & Unexpired Leases

11 U.S.C.S. § 365(a) provides that a debtor, subject to the court's approval, may assume or reject any executory contract or unexpired lease. A court may approve motions to assume, assume and assign, or reject executory contracts upon a showing that the debtor's decision to take such action will benefit the debtor's estate and is an exercise of sound business judgment.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

HN15[] Administrative Powers, Estate Property Lease, Sale & Use

11 U.S.C.S. § 363(b) provides that a debtor-in-possession after notice and a hearing may use, other than in the ordinary course of business, property of the estate. Under applicable case law, in this and other circuits, courts should authorize business transactions outside the ordinary course of business if the debtors have exercised sound business judgment.

Civil Procedure > Judgments > Entry of Judgments > General Overview

HN16[] Judgments, Entry of Judgments

Fed. R. Bankr. P. 6004(h) is intended to provide sufficient time for an objecting party to seek a stay pending appeal before an order can be implemented, and protect the objector's appellate rights.

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For Official Committee of **[**2]** Unsecured Creditors, Creditor Committee: Alan D. Halperin, Matthew J. Williams, Esq., Halperin Battaglia Raicht LLP, New

York, NY; Matthew Williams, Paul B. O'Neill, Thomas Moers Mayer, Kramer Levin Naftalis & Frankel, LLP, New York, NY.

P. Schoenfeld Asset Management, Creditor Committee, Pro se.

Judges: Hon. Burton R. Lifland, United States Bankruptcy Judge.

Opinion by: Burton R. Lifland

Opinion

[*570] Before: Hon. Burton R. Lifland

United States Bankruptcy Judge

MEMORANDUM OPINION APPROVING, IN PART, DEBTORS' MOTION FOR AUTHORIZATION TO ASSUME EMPLOYMENT AGREEMENTS, FOR APPROVAL OF A LONG TERM INCENTIVE PLAN AND RELATED RELIEF

Before the Court is the motion (the "Executive Compensation Motion") of Dana Corporation ("Dana" or collectively with its affiliated debtors, the "Debtors"), pursuant to *sections 105(a)*, 363(b), *365*, *502* and *503(c) of title 11 of the United States Code* (the "Bankruptcy Code"), for an order authorizing Debtors' assumption of the prepetition employment agreements (the "Employment Agreements") of Michael J. Burns, its President and Chief Executive Officer (the "CEO"), and senior executives of the core management team (the "Senior Executives"), as modified; allowing **[**3]** certain general unsecured claims against Debtors' estate under certain circumstances; approving a long-term performance based incentive plan (the "LTIP") for the CEO and Senior Executives; and Debtor's Motion for Clarification and Reconsideration, Pursuant to Rules 9023 and *9024 of the Federal Rules of Bankruptcy Procedure*, of Order Denying Executive Compensation Motion (the "Motion to Reconsider"). The Hearing on the Executive Compensation Motion and the Motion to Reconsider was held on November 21, 2006 (the "Hearing").

This is the Debtors' second effort to obtain approval of an executive compensation package for the CEO and Senior Executives. At the first hearing for such approval this Court found that the executive compensation plan proposed (the "Initial Compensation Motion") was wanting as an acceptable "incentive" plan. *See In re Dana Corp., 351 B.R. 96, 2006 WL* ***[*571]*** *2563458 (Bankr. S.D.N.Y. September 5, 2006)* (the "September 5 Order"). Following the September 5 Order denying the Debtors' motion to approve the Initial Compensation Motion, the Debtors negotiated with the official committee of unsecured creditors (the "Creditors' Committee") **[**4]** and official committee of equity security holders (the "Equity Committee") in an effort to reach a consensus on an acceptable compensation package. The Debtors assert, and the Committees agree, that the Executive Compensation Motion currently before this Court is a true incentivizing package for senior management and is wholly different than the initial proposal.

The Creditors' Committee and the Equity Committee filed statements in support of the Executive Compensation Motion, but maintained that the Court need not determine the Motion to Reconsider. The United States Trustee (the "U.S. Trustee"), the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (the "USW") [1] **[**5]** and United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (the "UAW") [2] (collectively the "Unions"), and the committee of non-union retirees (the "Non-Union Retiree Committee") oppose both the Executive Compensation Motion and the Motion to Reconsider.

HN1[↑] Generally, courts take a holistic view of and measure acceptability of compensation packages

[1] The USW is the exclusive collective bargaining representative of approximately 2,800 active Dana employees who are employed under the terms of collective bargaining agreements (the "CBAs") in effect between Dana and the USW. In addition, the USW serves as the "authorized representative" under *11 U.S.C. § 1114(c)* for certain retirees currently receiving retiree health benefits pursuant to the USW CBAs. The USW is the "authorized representative" of the retirees under *11 U.S.C. § 1114(c)*.

[2] The UAW is the exclusive collective bargaining representative of approximately 5,300 active employees of Dana Corporation ("Dana" or "Debtors") who are employed under the terms of CBAs in effect between Dana and the UAW. In addition, the UAW represents approximately 9,000 retirees currently receiving retiree health benefits pursuant to the UAW CBAs. The UAW is the "authorized representative" of the retirees under *11 U.S.C. § 1114(c)*.

through the prism of several factors including:

- whether the amount of cost or expense is reasonable and in the best interest of the estate;
- whether the services to be provided are likely to enhance a successful reorganization or liquidation of the debtor;
- whether the debtor exercised appropriate business judgment in implementing any application for continuing, resuming, or retaining the executive.

Recognizing the potential limitations of section 503(c) of the Bankruptcy Code as it applies **[**6]** to those employee retention provisions that are essentially "pay to stay" key employee retention programs ("KERPs"), yet viewing compensation packages holistically, [3] ***HN2***[] a *true* incentive plan may not be constrained by 503(c) limitations. I noted in the September 5 Order that merely because a plan has some retentive effect does not mean that the plan, overall, is retentive rather than incentivizing in nature.

As set forth below, the plan before this Court is substantially watered down and modified from the original employment **[*572]** agreements and from the Initial Compensation Motion. Accordingly, subject to the limitations or conditions set forth herein, the plan before this Court is consistent **[**7]** with section 503(c), is within the fair and reasonable business judgment of the Debtors and thus within the zone of acceptability.

BACKGROUND

On March 3, 2006 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The Debtors are leading suppliers of modules, systems and components for original equipment manufacturers and service customers in the light, commercial and off-highway vehicle markets. The products manufactured and supplied are used in cars, vans, sport-utility vehicles, light, medium and heavy trucks, and a wide range of off-highway vehicles. As disclosed in Dana's Form 10-K filed on April 27, 2006, for the year ended December 31, 2005, the Dana Companies recorded revenue of more than $ 8.6 billion and had assets of approximately $ 7.4 billion and liabilities totaling $ 6.8 billion. As of the Petition Date, the Dana Companies had approximately 44,000 employees. After the cases were commenced, the U.S. Trustee appointed the Creditors' Committee, the Equity Committee, and the Non-Union Retiree Committee.

On June 29, 2006, the Debtors filed the Initial Compensation Motion seeking authority to **[**8]** assume the employment agreements of the CEO and Senior Executives. Objections to the Initial Compensation Motion were filed by the U.S. Trustee, the Creditors' Committee, the Equity Committee, the *Ad Hoc* Noteholders' Committee and the Unions on the basis that the relief being sought violated section 503(c) of the Bankruptcy Code. The opposition, while general in form, focused primarily on the benefits proposed for the CEO. At the September 5, 2006 hearing, this Court denied the Initial Compensation Motion, finding that the plan presented to the Court was not an incentive plan, and that it violated section 503(c). However, as noted, this Court also opined that incentivizing plans with *some* components that arguably have a retentive effect do not necessarily violate section 503(c). *See* September 5 Order.

THE MOTION TO RECONSIDER

The Debtors' stated purpose in filing the Motion to Reconsider was to maintain flexibility while they negotiated with their stakeholders over the terms of a new plan. The Debtors have revamped their proposals and a new package is now before the Court. As such, the Executive Compensation Motion will be considered **[**9]** - standing alone-on its own merits. Moreover, as the Initial Compensation Motion was holistically denied by this Court, it serves no purpose to revisit portions of that plan when the new proposal will be considered *de novo*. Accordingly, the Motion to Reconsider is moot. [4]

EXECUTIVE COMPENSATION MOTION

In addition to base salary and an annual incentive plan (the "AIP"), the Employment Agreements of the CEO and Senior Executives, as modified, include the

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[3] Holistic is defined as, "relating to or concerned with wholes or with complete systems rather than with the analysis of, treatment of, or dissection into parts," i.e. the components have an existence other than as the mere sum of their parts. *See* MERRIAM-WEBSTER COLLEGIATE DICTIONARY 553 (Eleventh Ed. July 2003).

[4] In their Consolidated Reply to Objections to the Debtors' Motion for Clarification and Reconsideration, the Debtors ask this Court to determine whether the payment of the annual incentive plan to the CEO is ordinary course, which will be addressed *supra*.

following terms: [5]

[10] [*573]** PENSION BENEFITS

Dana proposes to assume one hundred percent of the Senior Executives' pension plans (ranging between $ 999,000 and $ 2.7 million) and sixty percent of the CEO's pension plan (60% of $ 5.9 million), with the remaining forty percent being allowed as a general unsecured claim. Assumption would take place upon emergence from bankruptcy or the Senior Executives' involuntary termination without cause, and with respect to the CEO, voluntary termination for good reason. The pension benefits would only be assumed on the condition that the salaried and bargaining unit defined benefit pension plans of Dana employees have not been terminated.

To the extent not assumed, one hundred percent of the pension benefits of CEO and Senior Executives would be treated as allowed general unsecured claims in their vested amount as of the Petition Date, with all postpetition accruals and credits allowed as administrative claims.

SEVERANCE

Should the need arise, the Debtors propose to pay the CEO and Senior Executives severance in an amount that complies with *section 503(c)(2) of the Bankruptcy Code*. To quell the fears of objecting parties, **[**11]** the Debtors agreed to submit a statement, upon the termination of the CEO or Senior Executive, detailing a calculation of the severance payment for which they are eligible, and allow sufficient notice [6] of such payment.

NON-DISCLOSURE AGREEMENT AND PRE-EMERGENCE OR POST-EMERGENCE CLAIM

In consideration for the assumption of their Employment Agreements and receipt of payments under the LTIP, the Senior Executives would execute a new non-compete, non-solicitation, **[**12]** non-disclosure and non-disparagement agreement (collectively, the "NDA Agreements") that would prohibit the Senior Executives from accepting a position with a competitor **[*574]** of Dana, disclosing Dana's confidential information to third parties, soliciting any employees of Dana or disparaging Dana for twelve months.

The CEO's Employment Agreement would be modified to include a provision that in the event the CEO is involuntarily terminated without cause or resigned for good reason prior to the Debtors' emergence from chapter 11, the CEO would be prohibited from accepting a position with a competitor of Dana, disclosing Dana's confidential information to third parties, soliciting any employees of Dana or disparaging Dana for six months. The pre-emergence claim (the Pre-Emergence Claim) of the CEO would be an allowed *general unsecured claim* in the amount of $ 4 million (with recovery limited to $ 3 million, less any severance actually paid under *section 503(c)(2) of the Bankruptcy Code*) on account of the CEO's claim relating to damages from termination of the Employment Agreement. The Pre-Emergence Claim would be freely assignable after termination.

In the **[**13]** event that the CEO is involuntarily terminated without cause or resigns for good reason *after* Dana's emergence from chapter 11, the CEO would be prohibited from accepting a position with a competitor of Dana, disclosing Dana's confidential information to third parties, soliciting any employees of Dana or disparaging Dana for twelve months (the "Post-Emergence NDA Agreement"). The post-emergence claim (the "Post-Emergence Claim") of $ 3 million would be paid ratably over the term of the Post-Emergence NDA Agreement on account of the CEO's claim for damages under the Employment Agreement.

In addition to the request to approve the assumption of the Employment Agreements, the Executive Compensation Motion requests approval of the LTIP. Under the LTIP, the CEO and Senior Executives [7] **[**15]** would be eligible for a long-term incentive

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[5] The Debtors' Executive Compensation Motion was submitted with a Term Sheet exhibit, containing metrics and interpretive data. The Term Sheet was submitted at the Hearing as Debtors' Exhibit 38.

[6] A severance payment notice would be served on the U.S. Trustee, the Equity and Creditors' Committees, the Unions, the Non-Union Retirees' Committee and the *Ad Hoc* Noteholders' Committee. If no party in interest objects within ten days from the date of the severance payment notice, the severance would be paid. If an objection is filed and cannot be resolved consensually, Dana would pay the undisputed amount of severance, if any, but the disputed amount of severance would not be paid absent a further order of the Court approving such payment.

[7] The structure of the payments is similar for the CEO and Senior Executives, with the Senior Executives receiving

bonus if the company reaches a certain EBITDAR, [8] and the amount of the incentive payment would increase if additional, higher EBITDAR benchmarks were reached. In order for the CEO to qualify for the minimum amount of the LTIP ($ 3 million), the company must achieve a 2007 EBITDAR of $ 250 million. The CEO would earn an additional $ 750,000 for each $ 100 **[**14]** million increase in EBITDAR, with a maximum payout of $ 4.5 million for 2007. In 2007, the first $ 3 million, if earned, would be paid in cash, with payment deferred to the post-emergence period, and any additional amounts would be paid in stock of the reorganized company. In 2008, a similar structure of minimum EBITDAR with incremental increases applies, but all payments would be made in the form of stock. The EBITDAR calculation is reduced, for purposes of the incremental increases only, by certain percentages for claims in excess of the unsecured claims threshold ($ 2.850 billion). [9] In sum, as Debtors' counsel noted at the hearing, if all EBITDAR goals were reached, over a three year period, the LTIP provides for $ 11 million payments in total to the six executives, $ 5 million of which is in cash, with the remainder in stock. *See* Transcript of Hearing, at p 83. The LTIP is a substantial reduction from the long-term incentives that were available prepetition to the CEO and Senior Executives prior to the bankruptcy filing.

In sum, Dana contends that the compensation provided in the Executive Compensation Motion is necessary and appropriate, and represents a reasonable exercise of the Debtors' business judgment, pursuant to *sections 363*, *365* and *502 of the Bankruptcy Code*, and are permissible under *section 503(c) of the Bankruptcy Code*. In denying the Initial Compensation Motion because it violated *section 503(c)*, I specifically expressed concern about certain aspects of the plan, including: the guaranteed completion bonus, the targets set for additional bonuses, and payments classified as non-compete payments. The Executive Compensation Motion currently before the Court arguably contains some similar provisions to the previous motion, **[**16]** but as I noted above, I am considering this plan anew in light of the many modifications, changes and alterations made. The plan before the Court today, unlike the previous iteration, has *no guaranteed payments* to the CEO or Senior Executives other than base salary and is a substantial retreat from the original proposals.

[*575] DISCUSSION

Senator Edward Kennedy proposed the amendment to *section 503 of the Bankruptcy Code* as a last-minute addition to the bill, expressing his concern over the "glaring abuses of the bankruptcy system by the executives of giant companies like Enron Corp. and WorldCom Inc. and Polaroid Corporation, who lined their own pockets, but left thousands of employees and retirees out in the cold." *See* Statement of Senator Edward Kennedy on the Bankruptcy Bill (March 1, 2005). Other members of Congress were concerned that Senator Kennedy's amendment would prevent responsible companies that needed to retain key employees to reorganize successfully and suggested that *section 503(c) of the Bankruptcy Code* should only prevent payments to insiders in the event of fraud, mismanagement, and conduct contributing **[**17]** to the debtor's insolvency. *See* CONG. REC. S2341 (Mar. 9, 2005) (statement of Sen. Orrin G. Hatch); CONG. REC. H2050-51 (Apr. 14, 2005) (statement of Rep. Chris Cannon). The modified language proposed by Senator Hatch that would have addressed the above concern was never included in the final bill. [10] *See Pub. L. No. 109-8, § 331, 119 Stat. 23, 102-03 (April 20, 2005)* ("BAPCA"); *see also In re U.S. Airways, 329 B.R. 793, 797 (Bankr. E.D. Va. 2005)*.

[18]** *HN3*[↑] *Section 503(c) of the BAPCA* restricts transfers or payments by debtors to the extent that such payments are outside the ordinary course. The predominate focus of the amendments to *section 503(c)* is on payments made to "insiders" of the debtor(s). However, *section 503(c)* was not intended to foreclose a chapter 11 debtor from *reasonably* compensating employees, including "insiders," for their contribution to

between $ 355,556 and $ 497,778 as a base amount and smaller increments.

[8] Earnings Before Interest, Taxes, Depreciation, Amortization and Restructuring Costs.

[9] The effect of this reduction is to prevent the CEO and Senior Executives from benefiting from rejecting contracts that ultimately result in a higher level of unsecured claims against the estate.

[10] In a letter to Senator Arlen Specter, Chairman, Committee of the Judiciary, the Association of Insolvency and Restructuring Advisors also expressed its concern that the bill could cause considerable harm to companies in bankruptcy and suggested that, "there must be a better approach than handcuffing the judiciary and stakeholders in bankruptcy cases by essentially precluding all KERPs." *See* Thomas J. Salerno and Rebecca S. Revich, KERPS, COMP AND BONUS ISSUES UNDER THE NEW CODE, INCLUDING PENSION BENEFITS AND UNION CONTRACTS, 060907 ABI-CLE 31 (Sept 2006).

the debtors' reorganization. *In re Nobex Corp., 2006 Bankr. LEXIS 417 (Bankr. D. Del. Jan. 19, 2006)*; *see also In re Werner Holding Co., Inc.*, Case No. 06-10578 (Bankr. D. Del. 2006).

HN4[🡅] *Section 503(c)(1)* prohibits the allowance and payment of sums to "insiders" "for the purpose of inducing such person to remain" with the business "absent a finding by the court based on the evidence in the record" that (1) the payment is "essential" to the retention of the individual "because the individual has a bona fide job offer from another business at the same or greater rate of compensation;" and (2) the services of that individual are "essential to the survival of the debtor's business." The KERP statute also fixes the measure of acceptable retention bonuses **[**19]** for insiders by linking them to a multiple of bonuses available to non-management employees. [11] **[*576]** The Debtors are not moving under *section 503(c)(1)*.

[20]** *HN5*[🡅] *Section 503(c)(2) of the Bankruptcy Code* allows severance payments to be made to insiders only if they are part of a generally applicable program and are less than ten times the amount of the mean severance pay given to non-management employees. *11 U.S.C. § 503(c)(2)*. The Second Circuit has defined "severance" as a form of "compensation for the termination of the employment relation, for reasons other than the displaced employees' misconduct, primarily to alleviate the consequent need for economic readjustment but also to recompense him for certain losses attributable to the dismissal." *Straus-Duparquet, Inc. v. Local Union No. 3, IBEW, 386 F.2d 649, 651 (2d Cir. 1967)*.

HN6[🡅] If *sections 503(c)(1)* and *(c)(2)* are not operative, a court may consider whether the payments are permissible under *section 503(c)(3)*, which limits payments made to management and employees, among others, outside of the ordinary course, unless such payments are shown to be justified under the facts and circumstances of the chapter 11 case. As one treatise points out, the test in *section 503(c)(3)* appears to be no more stringent a test than the one **[**21]** courts must apply in approving any administrative expense under *section 503(b)(1)(A)*. Any expense must be an actual, necessary cost or expense of preserving the estate. *4 Colliers on Bankruptcy § 503.17[3] (15th ed. 1982)*. Accordingly, *HN7*[🡅] *section 503(c)(3)* gives the court discretion as to bonus and incentive plans, which are not primarily motivated by retention or in the nature of severance. *See In re Nobex Corp., 2006 Bankr. LEXIS 417 (Bankr. D. Del. Jan. 19, 2006)* (court concluded that *section 503(c)(3)* was nothing more than a reiteration of the standard under 363 under which courts had previously authorized transfers outside the ordinary course of business based on the business judgment of the debtor).

Courts consider the following *HN8*[🡅] in determining if the structure of a compensation proposal and the process for developing the proposal meet the "sound business judgment" test:

> - Is there a reasonable relationship between the plan proposed and the results to be obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, *is the plan*

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[11] As noted by commentators,

> Under this section, a company will now be required to show not only that each key management employee has another offer, but also that they will take the offer absent a KERP. This is nearly an impossible standard to satisfy and would require that each such employee come to court and testify that they have another offer and will leave absent the KERP. Companies working through a chapter 11 reorganization will lose productivity while their key employees are out interviewing for jobs and many of these employees will simply leave. In addition, the amendment will require that the debtor prove that the services of the key employee are "essential to the survival of the business." But, for many chapter 11 companies with good prospects of reorganization, the crucial issue is not merely survival but value creation for their constituents. Even if the company cannot show it will "fail" due to the loss of the employee, successful reorganization usually depends on maximizing the value of the enterprise, which may depend on retention of key managers.

Ellen Hennessey, Marcia Goldstein, Scott E. Cohen, Matthew Weinstein, EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION PROVISIONS IN THE NEW CONSUMER BANKRUPTCY ACT, SL076 ALI-ABA 1917, 1923 -1924 (March 22-24, 2006); *see also* Karen Lee Turner, and Ronald S. Gellert, DANA HITS A ROADBLOCK: WHY POST-BAPCPA LAWS MAY IMPOSE STRICTER KERP STANDARDS, Andrews Bankruptcy Litigation Reporter, 3 No. 14 ANBKRLR 2 (November 6, 2006) ("the requirement under *Subsection (c)(1)(A)* nears absurdity where it forces an executive to seek and obtain a bona fide job offer in order for the debtor to be able to simply match that offer. It raises the question, Who would ever agree to remain with a sinking ship when a solvent company has made a competing job offer?").

calculated to achieve **[**22]** *the desired performance?* (emphasis added)
- Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?

[*577] - Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?
- Is the plan or proposal consistent with industry standards?

- What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?

- Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

In re The Colad Group, Inc., 324 B.R. 208 (W.D.N.Y. 2005); *In re Montgomery Ward Holding Corp., 242 B.R. 147, 154 (D. Del. 1999)*; *In re Brooklyn Hosp. Center, 341 B.R. 405 (Bankr. E.D.N.Y. 2006)*; *In re EaglePicher Holdings, Inc., 2005 Bankr. LEXIS 2894, 2005 WL 4030132 (Bankr. S.D.Ohio Aug 26, 2005)*; *In re Georgetown Steel Co., L.L.C., 306 B.R. 549 (Bankr. D.S.C. 2004)*; *In re Aerovox, Inc., 269 B.R. 74, 80-81 (Bankr. D. Mass. 2002)*; **[**23]** *In re AmericaWest Airlines, Inc., 171 B.R. 674, 678 (Bankr. D. Ariz. 1994)*; *Matter of Interco, Inc., 128 B.R. 229, 234 (Bankr. E.D. Mo. 1991)*.

As I observed in the September 5 Order, ". . . it may be possible to formulate a compensation package that passes muster under the section 363 business judgment rule or section 503(c) limitations. . . ." *See* September 5 Order. The Debtors contend that the Executive Compensation Motion before the Court today passes muster.

THE EMPLOYMENT AGREEMENTS

The Unions, Non-Union Retiree Committee and the U.S. Trustee (the "Objecting Parties") object to the assumption of the Employment Agreements on several grounds. First, they argue that the pension benefit is severance pay and is retentive in nature. These pension benefits are essentially the entire retirement package from Dana for the CEO and Senior Executives. The pension benefits do not vest until the executive has been at Dana for five years, and various interim accruing factors determine the actual amount of the benefits, making this a true pension plan. [12] The Senior Executives have already earned certain of the pension benefits, with more **[**24]** to be earned in the future, and the assumption of such benefits does not increase the amount of pension benefits to which they are currently entitled. Moreover, such assumption is not contingent upon any Senior Executive continuing to be employed by Dana for any particular period of time after assumption. To the extent these conditions have any retentive impact, it is merely incidental to the terms of the pension plans and are ordinary and customary in such plans.

[25]** Richard Priory, the Chairman of the Compensation Committee at Dana, testified [13] **[*578]** that the CEO and Senior Executives gave up retirement plans at their former employers with the expectation that similar benefits would be provided by Dana. *See* Transcript of Hearing, at p 15. The pension benefits would be assumed as part of the Employee Agreement, which originally provided for more lucrative pension benefits for the CEO. [14] **[**26]** Additionally, the assumption of the CEO and Senior Executives' pension plans is expressly tied to the non-termination of Dana's salaried and bargained unit defined benefit pension plans, which ensures parity of treatment of the pensions

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[12] *See, e.g., Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.), No. 04-CIV-2413, 2006 U.S. Dist. LEXIS 8029, at *7 (S.D.N.Y. Mar. 1, 2006)* (holding that a supplemental executive retirement program was not a "severance payment" because the employee's termination, "did not trigger his entitlement to benefits under the program. . . . Since he had completed five years of management services pre-petition, [the employee] was already entitled to benefits under the program . . . upon his retirement. His termination merely accelerated the payment of his benefits under the program since he was terminated other than for cause. . . . "); *see also* Executive Benefits: A Survey of Current Trends: 2003 Results, Clark Consulting, (Clark Consulting, North Barrington, IL Jan. 2004) (firms provide pensions to executives mainly through nonqualified supplemental executive retirement plans (SERPs), the key benefits being the supplemental retirement income that they provide and the survivor benefit in case of the executive's premature death).

[13] Testimony was offered by proffer during the Hearing, subject to cross-examination.

[14] Mr. Priory testified that the CEO had pension benefits with GM, his former employer of 30 years, that amounted to just less than $ 10 million when he left GM and went to Dana. *See* Transcript of Hearing, at p 15.

of the CEO [15] and Senior Executives and Dana's other employees. The pension benefits, therefore, are not retentive in nature and are not severance, rather they are customary pension plans and their assumption is subject to the Debtors' business judgment.

Second, the Objecting Parties contend that the Pre-Emergence Claim and Post-Emergence Claim violate section 503(c). The Pre-Emergence Claim is a general unsecured claim. Section 503(c) of the Bankruptcy Code, which on its face only limits the allowance and payment of *administrative* claims, is not violated. *See* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6, 120 S. Ct. 1942, 147 L. Ed. 2d 1 (2000) (quoting **HN9**[] United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989)) ("where the statute's language is plain the sole function of the courts, at least where the disposition of the statute's text is not absurd, is to enforce the statute according to its terms"). The U.S. Trustee suggests that Congress meant to prevent debtors from providing *any* sort of compensation to executives of debtors in possession that might **[**27]** in any way be construed as retentive, however **HN10**[] the language of section 503(c) is clear and unambiguous that *only administrative claims* are subject to section 503(c) restrictions.

The Post-Emergence Claim would be earned only if the CEO continues to comply with the terms of the agreement after dismissal (and not merely upon dismissal). Debtors point out that the payment is not for the loss of employment, but rather it is to compensate the employee for losses attributable to foregoing post-termination opportunities that if accepted, could result in direct detriment of Dana. [16] *See* Straus-Duparquet, Inc. v. Local Union **[*579]** No. 3, IBEW, 386 F.2d 649, 651 (2d Cir. 1967).

[28]** Dana contends that the $ 3 million post-emergence payment to the CEO is permissible because it would be paid only after the Debtors emerge from chapter 11 and therefore the Debtors will no longer be constrained by section 503(c). However, to the extent that the $ 3 million payment is subject to further review and must be passed upon as a provision in a disclosure statement and plan of reorganization, the Court cannot, at this early point in the cases, guarantee that the payment will be ultimately approved.

The Board believes that given the CEO and Senior Executives' extensive knowledge of Dana's operations, customers and strategies, the continuing presence of the CEO and Senior Executives is crucial for the Debtors' operations and challenges of restructuring. The Board came to the conclusion that this CEO and the Senior Executive team that he had assembled was the "right team" to run the company. *See* Transcript of Hearing, at p 20.

At the Hearing, Mr. Priory, testified that the Compensation Committee, with advice from Dana's outside expert on executive compensation, Mercer Human Resources Consulting, and the Compensation Committee's own independent compensation consultant, **[**29]** Frederic W. Cook & Co., Inc., worked to determine the appropriate level of compensation for the CEO and Senior Executives after the Petition Date. Mr. Priory noted, "[b]y the time Mr. Burns went through the process of having his compensation stripped away Mr. Burns was not only below mean, but way below the median." *See* Transcript of Hearing, at p 21-22. After the Initial Compensation Motion was denied by this Court, the team went back to the drawing board, and included the Creditors' Committee and Equity Committee in its deliberations. Together, they devised the Executive Compensation Motion before the Court today. *See* Transcript of Hearing, at p 19-20. [17]

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[15] Only if Dana's other employees receive their full pension benefits will the CEO be eligible to receive sixty percent of his pension benefits, with the remaining forty percent being allowed as a general unsecured claim.

[16] Mr. Stenger testified that one of the driving forces behind the company securing the non-compete, non-disclosure and non-disparagement provisions was, "that if any of these senior managers left the company that they would be tied up in a non compete so that the knowledge they acquired about Dana could not be used by the competitors." Transcript of the Hearing, at p 21. Apparently, this is a common concern among employers. *See i.e.* Stewart J. Schwab, Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?* 63 WASH. & LEE L. REV. 231, 254 (Winter 2006) ("One of the major issues in a CEO contract is whether the CEO can continue working in the industry after leaving the particular company. From the company's perspective, it does not want a CEO to learn its strengths and weaknesses and then go to work for a competitor and exploit that inside knowledge.").

[17] Mr. Priory also testified, "[the board members] have confirmed that while this is less than they believe is fair compensation for these individuals given the circumstances, if it's acceptable to the individuals, Mr. Burns for example, they

[30]** This uncontroverted evidence supports the Debtors' contention that they exercised fair and reasonable business judgment in determining to assume the Employment Agreements of the CEO and Senior Executives.

THE AIP (ANNUAL INCENTIVE PLAN)

The 2006 Annual Incentive Plan (the "AIP"), is a refinement of the 2005 short-term incentive program, reflecting current business conditions and a reduction in the number of participants, and is similar to Dana's previous short-term incentive programs. [18] Dana contends that the continuance of the AIP is a transaction in the ordinary course of business for which no court approval is needed, and **[*580]** contends that no approval was sought. [19] The parties opposing the Debtors' motion contend that the AIP is not in the ordinary course and that it was restructured just before the Petition Date. Dana's Board of Directors authorized the bonuses payable under the AIP on February 28, 2006; in the same timeframe the AIP is typically authorized. The AIP, like its predecessor programs, provides short-term performance-based incentives to hundreds of key employees of Dana and its subsidiaries for 2006, including the Senior Executives and CEO. *See* **[**31]** Form 8-K, filed March 6, 2006; *see also* Transcript of Hearing, at p 17.

HN11[↑] The Bankruptcy Code is designed to allow a debtor-in-possession the flexibility to engage in ordinary transactions without unneeded oversight **[**32]** by creditors or the court, while at the same time giving creditors an opportunity to contest those transactions that are not ordinary. *See In re Crystal Apparel, Inc., 207 B.R. 406, 409 (S.D.N.Y. 1997)* (*citing In re Roth American, Inc., 975 F.2d 949, 952 (3d Cir. 1992)*). This balance between allowing businesses to continue their daily operations on the one hand, and protecting creditors from squandering the estate's assets on the other, is reflected in *section 363(c)(1) of the Bankruptcy Code*:

> ***HN12***[↑] If the business of the debtor is authorized to be operated under . . . this title and unless the court orders otherwise, the trustee may enter into transactions . . . in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

Id. citing 11 U.S.C. § 363(c)(1). ***HN13***[↑] The Bankruptcy Code does not provide guidance as to whether a particular transaction was conducted "in the ordinary course of business" but courts have applied a two-step "horizontal and vertical test" that considers the reasonableness of **[**33]** the transaction from an industry-wide perspective and from the viewpoint of a creditor:

> The inquiry deemed horizontal is whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry. The inquiry deemed vertical analyzes the transactions 'from the vantage point of a hypothetical creditor and [the inquiry is] whether the transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided to extend credit.

In re Crystal Apparel, Inc., 207 B.R. at 409 (citations omitted). *See also In re Dant & Russell, Inc., 853 F.2d 700, 704-05 (9th Cir.1988)*; *In re Drexel Burnham Lambert Group, Inc., 157 B.R. 532, 537 (S.D.N.Y.1993)*; *Comm. of Asbestos-Related Litigants and/or Creditors v. Johns-Manville Corp. (In re Johns-Manville Corp.), 60 B.R. 612, 616-19 (Bankr. S.D.N.Y. 1986)* (This Court examined the horizontal and vertical tests for ordinary course transactions in depth and stating that, "[o]nly extraordinary transactions which are 'different from those that might be expected to take place,' need be brought **[**34]** to the attention of creditors and other interested parties to allow them to voice any objections to the debtor's proposals").

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are prepared to go forward and we believe it incents each of these individuals to drive for emergence and incents each of these individuals to achieve what has been the target set by this company to get through this process." *See* Transcript of Hearing, at p 23.

[18] For over 50 years, prior to 2005, Dana utilized annual short-term incentive plans under which employees would receive incentive payments if they met certain performance goals established at the beginning of the year. In 2005, as part of Dana's ongoing efforts to focus its leadership on critical performance measurements, the approximately 2,000 Dana employees participating in short-term incentive programs throughout Dana, were consolidated under one Dana-wide incentive program. No bonuses were paid under the 2005 short-term incentive program because the incentive targets for that year were *not attained*.

[19] In August 2006, during the pendency of the Executive Compensation Motion, Dana made semi-annual AIP payments to all Senior Executives (except the CEO), and also to eligible employees.

The Objecting Parties argue that the AIP is not ordinary course and should not be approved, citing the order in *In re Delphi Corp.*, Case No. 05-44481 (RDD) (July 21, 2006) (the "Delphi Order"), in support of that contention. In *Delphi* **[*581]** however, the annual incentive plan was only one part of a Key Employee Compensation Plan for which Delphi sought approval and was developed by the debtors specifically for postpetition implementation. The AIP component of the Delphi plan was, "developed in order to encourage participants to increase the [d]ebtors' enterprise value, and thus increase value and returns for all stakeholders during the debtors' chapter 11 cases" and was different than the incentive plan in place prepetition. *See In re Delphi Corp.,* Case No. 05-44481, ECF # 13, Motion for an Order under *11 U.S.C. §§ 105(a)* and 363(b)(1) Authorizing the Debtors to Implement a Key Employee Compensation Program, dated October 8, 2005.

In contrast, a short-term incentive plan has been a common component **[**35]** of compensation plans at Dana for the past fifty years and does not differ significantly from Dana's prepetition practice. Accordingly, it is within the ordinary course of Debtors' business. *See i.e., In re American Plumbing & Mechanical, Inc. 323 B.R. 442 (Bankr. W.D. Tex. 2005)* (incentive bonus program deemed ordinary course although bonus payments not entitled to administrative priority). However, the payments to be made under the AIP to the Executives must be considered in the context of determining whether the overall compensation proposal is a proper exercise of Debtors' business judgment. [20]

[36]** THE LTIP

The LTIP requires that the company reach certain EBITDAR benchmarks before the CEO and Senior Executives will be eligible for any payment under the long-term incentive plan. This aspect of the bonus is a significant change from the terms of the doomed Initial Compensation Motion, where Debtors' sought approval of a completion bonus, awarded upon emergence from chapter 11 and a separate bonus based on total enterprise value of the company upon emergence, with a bonus being awarded even if the total enterprise value of the company declined by the time the company emerged. The Debtors assert that the proposed EBITDAR minimum benchmarks will require management to "stretch" in order to achieve superior operating results for the Debtors, particularly in the difficult and rapidly deteriorating auto industry. The Objecting Parties argue that EBITDAR required over the first six months of 2006 indicates that the 2007 EBITDAR for the CEO and Senior Executives to be paid their minimum LTIP is "virtually guaranteed." Based upon the uncontroverted evidence at the hearing, however, achievement of the EBITDAR benchmarks is uncertain, at best.

Ted Stenger, a managing director **[**37]** at Alix Partners and the Debtors' Chief Restructuring Officer, testified that although, as of September 30, 2006, the Debtors had **[*582]** reached an EBITDAR of $ 235 million, the remainder of the year would finish at about that level. Mr. Stenger explained that the first half of the year resulted in $ 175 million EBITDAR with the second half only expected to add only $ 750,000 due to a significant decline in sales. Much of the Debtors' negative performance is due to the state of the automotive industry in general, [21] **[**39]** the increasing

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[20] **HN14**[🡅] *Section 365(a) of the Bankruptcy Code* provides that a debtor, "subject to the court's approval, may assume or reject any executory contract or unexpired lease." *11 U.S.C. § 365(a)*. A court may approve motions to assume, assume and assign or reject executory contracts upon a showing that the debtor's decision to take such action will benefit the debtor's estate and is an exercise of sound business judgment. *See Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1098 (2d Cir. 1993)*. **HN15**[🡅] Section 363(b) provides, in relevant part, that a debtor-in-possession "after notice and a hearing, may use . . . other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). Under applicable case law, in this and other circuits, courts should authorize business transactions outside the ordinary course of business if the Debtors have exercised sound business judgment. *See In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983)*. *See also*, discussion on section 503(c)(3), *supra*.

[21] The dire state of the auto industry has been reported by Debtors' counsel at hearings throughout these cases and in the press. *See i.e.* Thomas Content, *Suppliers Must Think Globally, Leaders Say Many in Auto Parts Industry are Struggling*, MILWAUKEE JOURNAL SENTINEL, Aug. 9, 2006, at D1 ("'The past 18 months in the automotive supply world has been particularly painful and challenging. Much of our industry went into a 'hunker-down' mode, and in many cases, companies placed well-thought-out strategies on hold while they fought for survival,' said Tom Amato, an executive vice president of Metaldyne Corp., a supplier based in Plymouth, Mich."); *Dana Has New Cuts in Mind to Save $ 540 Million*, ST. LOUIS POST DISPATCH, November 10, 2006, at B2 ("Dana is among the auto parts manufacturers hit hard by U.S.

cost of materials, [22] and Dana's dependency on Ford, General Motors and Daimler-Chrysler (the "Detroit 3") which have recently instituted unprecedented cutbacks. [23] Specifically with respect to Dana's automotive systems group, which manufactures parts for pick-up trucks and SUVs, Dana has suffered severe losses and anticipates a $ 750 million decline in sales of light trucks in 2007. In addition, Mr. Stenger noted that due to pre-buying of medium and heavy-duty trucks in 2006 in advance of changes in regulatory emissions standards that will take effect in the United States in the beginning of 2007, the Debtors anticipate decreases of approximately 47% in North **[**38]** American heavy-duty truck build and 19% in medium-duty truck build, compared to 2006. This reduction will have a significant adverse impact on the Debtors, **[*583]** reducing their sales in these markets by an estimated $ 500 million in 2007. Mr. Stenger stated that although the Debtors are planning major cost cutting initiatives, the benefits depend upon the speed at which the Debtors can institute those measures, and some involve negotiations with third parties and are therefore unpredictable. *See* Transcript of Hearing, at 30-31.

[40]** Due to these factors, among others, Mr. Stenger expects 2007-2008 EBITDAR levels will not reach the 2006 number. *See* Transcript of Hearing, at 27-30. When pressed on cross-examination, Mr. Stenger opined that the pro forma EBITDAR for 2007 is $ 210 million. *See* Transcript of Hearing, at p 42. As such, the benchmarks for the LTIP are difficult targets to reach and are clearly not "lay-ups." [24] In sum, the LTIP is not a KERP, but is a program designed to incentivize the CEO and Senior Executives, and may be assumed by the Debtors if it is a fair and reasonable exercise of business judgment.

Returning to the **[**41]** holistic approach discussed earlier, in order to determine the reasonableness and cost effectiveness of the compensation levels, one must consider the total compensation that could potentially be earned by the CEO [25] **[**42]** and Senior Executives during the chapter 11 proceedings. The information before this Court indicates that the only compensation to be earned by the CEO and Senior Executives in 2006 is their salary [26] and the potential for AIP payments of up to $ 2 million for the CEO and between $ 336,000 to $

auto industry's financial woes. Other manufacturers in Chapter 11 bankruptcy are Delphi Corp., Tower Automotive Inc., Collins & Aikman Corp. and Dura Automotive Systems Inc.").

[22] Mr. Stenger testified that the cost of aluminum, nickel, stainless steel, copper and brass are increasing. *See* Transcript of Hearing, at p 32.

[23] As noted by the press, "The big hit will come in the fourth quarter, when Ford will periodically idle workers at 10 U.S. and Canadian plants as it slashes pickup truck and sport utility vehicle production by 28%. Soaring fuel prices have hit hard at Ford and its Big Three rivals General Motors Corp. and Chrysler Group, all heavily dependent on trucks, as buyers have begun shifting to smaller, lighter and more fuel-efficient cars and car-based crossover vehicles. 'The short-term ramifications will be ugly. . . . The sharp decline in production volumes will make it more difficult to see any signs of a turnaround at Ford,' said Craig Hutson, an auto industry bond analyst at Gimme Credit." John O'Dell, *Ford to Make Fewer Vehicles*, LOS ANGELES TIMES, Aug. 19, 2006, at Business. "The slowdown [in production by Ford] represented the deepest production cuts since the industry's crisis of the 1980's. It also underscored the difficulty that Detroit, whose business relies on sales of sport utility vehicles and pickup trucks, is having as gas prices remain around $ 3 a gallon. Detroit's market share has dropped to its lowest level in history . . ." Micheline Maynard, *Ford is Slashing Production 20% for 4th Quarter*, NEW YORK TIMES, Aug. 19, 2006, at A1. "In another indication of the industry's struggles, DaimlerChrysler said Friday that its Chrysler Group would lose twice as much money in the third quarter as previously estimated and said the unit would cut production in the third and fourth quarters to reduce dealer inventories." Martin Zimmerman, *Ford, in Tailspin, Speeds Cutbacks*, LOS ANGELES TIMES, Sept. 16, 2006, at Main News. "'My biggest thing I worry about on a day-to-day basis is who's going to go bankrupt next,' said James Applegate, president of a supply chain solutions with the logistics firm National Logistics Management." Thomas Content, *Suppliers Must Think Globally, Leaders Say Many in Auto Parts Industry are Struggling*, MILWAUKEE JOURNAL SENTINEL, Aug. 9, 2006, at D1.

[24] In the hearing on the Initial Compensation Motion, the Creditors' Committee suggested that the levels set for the incentive program were a "lay up" (a cinch to achieve, a softball). At the Hearing on November 21, 2006, the Creditors' Committee, in support of the Executive Compensation Motion pointed out that the terms of the LTIP were no longer a lay up and in fact truly incentivizing.

[25] Mr. Priory indicated in his testimony at the Hearing that the CEO's incentive package was devised to replace the package provided under this initial, pre-bankruptcy, employment agreement, which included a significant amount of now devalued Dana stock in lieu of cash-a risk the CEO assumed without a backstop guarantee and without a legitimate expectation of being made whole, dollar for dollar, post-petition.

[26] The CEO's 2006 salary is $ 1,552,500 and the Senior Executives' 2006 salaries range from $ 500,000 to $ 600,000.

528,000 for the Senior Executives. The 2007 compensation packages, however, include salary, an AIP and a LTIP. In 2007, when the CEO and Senior Executives are eligible for significant long-term incentive bonuses, [27] they may also be eligible for AIPs of up to 200% of the their salary. [28]

Looking at the packages through the previously identified prism of whether the cost or expense is reasonable and in the best interests of the estate, the present record is not sufficiently transparent to support an affirmative finding. The Debtors have made a record supporting the reasonableness and cost effectiveness of providing a base salary and LTIP for 2007. However, if *augmented* by an AIP bonus, the potential compensation earned for services **[**43]** during the course of the pre-confirmation period (2007, *et. seq.*) is not transparent from this record and may well be **[*584]** outside the realm of reasonableness, disproportionate and overly generous. [29] Although this Court has considered the "no guarantee" aspect of the package and the different timing of the long-term versus the short-term payments, the inclusion of both incentive programs in 2007 and 2008, in their current form, may not accomplish the "sharing the pain" objective. [30]

[44]** This Court is inclined to approve the LTIP provided that an appropriate yearly ceiling is placed on each of the CEO and Senior Executives' total compensation earned during the reorganization period.

WAIVER OF THE STAY

Debtors have requested that the Court waive the ten-day stay otherwise operable pursuant to Bankruptcy Rule 6004(h), on the grounds that they have articulated sound business reasons for the new proposal, and because of "significant uncertainty" relating to the CEO and Senior Executives' compensation since the Initial Compensation Motion was proposed.

HN16[] Bankruptcy Rule 6004(h) is intended to provide sufficient time for an objecting party to seek a stay pending appeal before an order can be implemented, and protect the objector's appellate rights. In re Quanalyze Oil & Gas Corp., 250 B.R. 83, 88 (Bankr. W.D. Tex. 2000) (*citing* Advisory Committee Note (1999), FED. R. BANKR. P. 6004 (Norton Bankr. Rules Pamphl. 1999-2000 Edition -- page 325)). No specific exigencies sufficient to support the Debtors' request have been demonstrated.

CONCLUSION

By presenting an executive compensation **[**45]** package that properly incentivizes the CEO and Senior Executives to produce and increase the value of the estate, the Debtors have established that section 503(c)(1) does not apply to the Executive Compensation Motion. Additionally, the Debtors have satisfactorily established that none of the payments proposed violate section 503(c)(2), as the Executive Compensation Motion specifically limits "severance" payments to those permissible under section 503(c)(2) and any other payments are non-severance in nature.

With the exceptions noted herein, pursuant to sections 503(c)(3), 363(b) and 365, the Debtors have presented this Court with unconverted evidence that the assumption of the Employment Agreements and the adoption of the LTIP is fair and reasonable and well within the Debtors' business judgment. Accordingly, the Executive Compensation Motion is granted, conditioned on the submission of an order including an appropriate ceiling or cap on the total level of yearly compensation to be earned by the CEO and Senior Executives during the course of the bankruptcy proceedings.

SETTLE AN ORDER [31] CONSISTENT WITH THIS

[27] In the case of the CEO, the 2007 LTIP bonus, if earned is between approximately 200% of his salary and 300% of his salary.

[28] In SEC papers filed by the Debtors, they indicate that the CEO would potentially be eligible for AIP bonuses of up to 200% of his salary. The range for the Senior Executives, however, is unclear. It may be between 80% and 120% of their salaries, however the document also states generally that 200% of salary is available for superior performance. No metrics are available for the 2007 AIP.

[29] Specifically, the CEO's incentive bonuses for 2007 could potentially be several multiples of his salary.

[30] Notably, the CEO, with curious timing, issued a letter to employees and former employees of Dana in the days after this Executive Compensation Motion was filed. The letter indicated that the Debtors, in order to accomplish a successful restructuring, would have to close plants, terminate employees, modify collective bargaining agreements and potentially terminate retiree benefits. The CEO noted that the initiatives outlined in the letter "involve sacrifices by all Dana stakeholders." The Debtors repeatedly referred to the diminished executive compensation package as a way to share the sacrifice with others involved in the cases.

[31] In the course of settling an order, the Court expects that the

OPINION THAT [*585] PROVIDES FOR A CEILING AS SET FORTH HEREIN ABOVE. [**46]

Dated: New York, New York

November 30, 2006

/s/ Hon. Burton R. Lifland

United States Bankruptcy Judge

ORDER PURSUANT TO *BANKRUPTCY RULE 9019*, APPROVING A SETTLEMENT AGREEMENT AMONG THE DEBTORS AND DANA CREDIT CORPORATION

This matter coming before the Court on the Motion of Debtors and Debtors in Possession, Pursuant to Bankruptcy Rule 9019 for an Order Approving a Settlement Agreement Among the Debtors and Dana Credit Corporation (the "Motion"), [1] filed by the debtors and debtors in possession in the above-captioned cases (collectively, the "Debtors"); the Court having reviewed the Motion and having considered the statements of counsel at a hearing before the Court (the "Hearing"); and the Court having found that (a) the Court has jurisdiction over this matter pursuant to *28 U.S.C. §§ 157* and *1334*, (b) [**47] this is a core proceeding pursuant to *28 U.S.C. § 157(b)*, *(c)* notice of the Motion and the Hearing was sufficient under the circumstances, (d) in light of the circumstances, the requirements of *local Bankruptcy Rule 9013-1(b)* that a separate memorandum of law be filed in support of the Motion is waived, (e) the decision of Debtors to enter into the Settlement Agreement, attached hereto, [2] is a reasonable exercise of their business judgment and the terms of the Settlement Agreement are reasonable; and the Court having determined that the legal and factual bases set forth in the Motion and at the Hearing establish grounds for the relief granted herein, including just cause;

IT IS HEREBY ORDERED THAT:

1. The Motion is [**48] GRANTED.

2. The Settlement Agreement is approved in all respects. The Debtors are authorized to enter into and perform their obligations under the Settlement Agreement.

3. The Debtors are authorized to take all such actions as are necessary or appropriate to implement the terms of this Order and the Settlement Agreement.

4. This Court shall retain jurisdiction to resolve all matters relating to the implementation of this Order.

Dated: New York, New York

November 30, 2006

/s/ Burton R. Lifland

UNITED STATES BANKRUPTCY JUDGE

End of Document

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parties will attempt to reach a consensus as to an appropriate ceiling amount.

[1] Capitalized terms not otherwise defined herein shall have the meanings given to them in the Motion.

[2] For purposes of this Order, the Settlement Agreement shall include that certain letter agreement dated November 29, 2006, between Dana and Dana Credit Corporation.

Positive
As of: March 27, 2019 4:09 PM Z

In re Pilgrim's Pride Corp.

United States Bankruptcy Court for the Northern District of Texas, Fort Worth Division

February 26, 2009, Decided

Chapter 11, Case No. 08-45664 (DML), JOINTLY ADMINISTERED

Reporter
401 B.R. 229 *; 2009 Bankr. LEXIS 312 **

In re PILGRIM'S PRIDE CORPORATION, et al., Debtors.

Subsequent History: Related proceeding at *Hall v. Thomas, 2010 U.S. Dist. LEXIS 129178 (N.D. Ala., Nov. 29, 2010)*

Prior History: *In re Pilgrim's Pride Corp., 2009 Bankr. LEXIS 264 (Bankr. N.D. Tex., Feb. 20, 2009)*

Core Terms

insider, consulting agreement, severance, customers, Resignation, enforceable, non-competition, compete, cases, consultants, obligations, argues, ordinary course of business, commencement, transfers, calendar year, competitors, employees, circumstances, transactions, provisions, terminated, Sections, covenant, services, estates, reasons, induce, terms, rule rule rule

Case Summary

Procedural Posture

The Chapter 11 debtors filed a motion for an order, pursuant to *11 U.S.C.S. §§ 363(b)* and *503(c)(3)*, to enter a consulting agreement with their former officers. The United States Trustee (UST) objected to the motion.

Overview

Two former officers resigned. The debtors filed a motion to employ the former officers for 4 and 3 months at their pre-resignation salaries in order to establish relationships with customers and prevent them from soliciting the debtors' customers on behalf of competitors. The court recharacterized the motion as seeking to purchase non-competition agreements from the former officers or insiders at the commencement of the case and inducing them not to work for a competitor for a limited period of time. The agreements were not for the purpose of causing them to remain with the debtors' business in conflict with *11 U.S.C.S. § 503(c)(1)*. The court held that the payments proposed by the motion were not intended as severance and did not have more than a tangential relationship to the termination of the officers, who had been paid severance as permitted by *§ 503(c)(2)*. The court held that such a transfer outside the ordinary course of business was not inconsistent with *§ 503(c)(3)*. The court held that the agreements, entered pursuant to a court order, were enforceable against the debtors and satisfied *Tex. Bus. & Com. Code Ann. § 15.50(a)*.

Outcome

The court granted the motion and overruled the objection.

LexisNexis® Headnotes

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN1[] **Unsecured Priority Claims, Administrative Expenses**

See *11 U.S.C.S. § 503(c)*.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN2[] **Unsecured Priority Claims, Administrative Expenses**

The language of *11 U.S.C.S. § 503(c)(1)* applies to a transfer made to, or an obligation incurred for the benefit of, an insider for the purpose of inducing such person to remain with the debtor's business. This provision is directed at so-called key employee retention programs.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN3[] Unsecured Priority Claims, Administrative Expenses

The language of *11 U.S.C.S. § 503(c)(2)* bars a severance payment to an insider of the debtor unless the payment is in accordance with the tests set out in that section.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN4[] Unsecured Priority Claims, Administrative Expenses

If a debtor may pay a terminated insider not to compete, the result may be that debtors will seek to evade *11 U.S.C.S. § 503(c)(2)*'s limit on severance pay through negotiation of a noncompetition agreement. However, any such agreement will still require court approval under *§ 503(c)(3)*, and an agreement which is clearly improvident or a subterfuge will not receive such approval.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN5[] Unsecured Priority Claims, Administrative Expenses

The language of *11 U.S.C.S. § 503(c)(3)* is not plainly limited in its scope even to transactions with insider employees.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN6[] Unsecured Priority Claims, Administrative Expenses

The language of *11 U.S.C.S. § 503(c)(3)* clearly will apply to any transfer or obligation to an insider that is outside the ordinary course of business. *Section 503(c)(3)*, however, does not prohibit such a transfer or obligation. Rather, it conditions approval of a proposed transfer or obligation upon such being justified by the facts and circumstances of the case.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN7[] Unsecured Priority Claims, Administrative Expenses

An insider is defined as including directors and officers of a corporate debtor. *11 U.S.C.S. § 101(31)(B)*. For purposes of *11 U.S.C.S. § 503(c)*, anyone who was an officer or director of a debtor as of commencement of the debtor's bankruptcy case is an insider.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

Bankruptcy Law > ... > Administrative Powers > Estate Property Lease, Sale & Use > Ordinary Course of Business

HN8[] Unsecured Priority Claims, Administrative Expenses

The test of *11 U.S.C.S. § 503(c)(3)* should not be equated to the business judgment rule as applied under *11 U.S.C.S. § 363(b)(1)*. First, to do so would mean that *11 U.S.C.S. § 503(c)(3)* is redundant. A transfer made or an obligation incurred outside the ordinary course of a debtor's business would fall within *11 U.S.C.S. § 363(b)(1)* in the absence of *11 U.S.C.S. § 503(c)(3)*, and, thus, the latter provision would add nothing to the Bankruptcy Code. Congress is presumed to intend that independent sections of the Bankruptcy Code will have independent, differing impacts. To read *11 U.S.C.S. § 503(c)(3)* as requiring nothing not already required by *11 U.S.C.S. § 363(b)(1)* would violate this principle of construction.

Bankruptcy Law > ... > Unsecured Priority Claims > Administrative Expenses > General Overview

HN9[] Unsecured Priority Claims, Administrative Expenses

The language of *11 U.S.C.S. § 503(c)(3)* is intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it. This requirement means that the court must make its own determination that the transaction will serve the interests of creditors and the debtor's estate. Put another way, when a transaction is proposed between a debtor and its insiders, the court cannot simply rely on the debtor's business judgment to ensure creditors and the debtor's estate are being properly cared for. Given the obvious conflict of interest between a debtor's estate and insiders, who may themselves have been responsible in whole or part for devising and internally approving the proposed transaction the argument underlying application of the business judgment rule (that officers and directors will fulfill their fiduciary responsibilities) lacks its usual weight.

Labor & Employment Law > ... > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements

HN10[] Trade Secrets & Unfair Competition, Noncompetition & Nondisclosure Agreements

See *Tex. Bus. & Com. Code Ann. § 15.50(a)*.

Labor & Employment Law > ... > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements

HN11[] Trade Secrets & Unfair Competition, Noncompetition & Nondisclosure Agreements

Tex. Bus. & Com. Code Ann. § 15.50(a) requires only that the agreement be enforceable, not that it be, or, from the promissee's perspective, that it be intended to be, actually enforced.

Labor & Employment Law > ... > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements

HN12[] Trade Secrets & Unfair Competition, Noncompetition & Nondisclosure Agreements

Tex. Bus. & Com. Code Ann. § 15.50(a) is intended primarily to protect the promissor, namely, the party promising not to compete, not the beneficiary of the covenant not to compete.

Counsel: [1]** For Pilgrims Pride Corporation, fka WLR Foods, Inc., fka AgraTech Seeds Inc., fka Wampler Foods, Inc., fka Gold Kist Inc., fka Pilgrims Pride Corporation of Georgia, Inc., fka GK Peanuts, Inc., fka WLR, fka Pilgrims Pride Corporation of Virginia, Inc., fka Pilgrims Pride Corporation of Delaware, Inc., Debtor: Elisa R. Behar Lemmer, New York, NY; Gary T. Holtzzer, Martin A. Sosland, Weil, Gotshal & Manges LLP, Dallas, TX; Stephen A. Youngman, Weil, Gotshal & Manges, Dallas, TX; Victoria Vron, Weil Gotshal & Manges LLP, New York, NY.

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For Official Committee of Unsecured Creditors, Creditor Committee: Andrews & Kurth, Dallas, TX; Jason S. Brookner, Andrews Kurth LLP, Dallas, TX; Jonathan Irvin Levine, Paul N. Silverstein, Andrews Kurth LLP, New York, NY.

Judges: D. Michael Lynn, United States Bankruptcy Judge.

Opinion by: D. Michael Lynn

Opinion

[*232] Corrected

MEMORANDUM OPINION

[Related to Docket No. 427]

Before the court is Debtors' Motion for an Order Pursuant to *Sections 363(b)* and *503(c)(3) of the Bankruptcy Code* to Enter into Consulting Agreements with J. Clinton Rivers and Robert A. Wright (the "Motion") [1] filed by **[**2]** Debtors. The United States Trustee (the "UST") responded to the Motion by filing its Objection to Debtors' Motion for an Order Pursuant to *Sections 363(b)* and *503(c)(3) of the Bankruptcy Code* to Enter into Consulting Agreements with J. Clinton Rivers and Robert A. Wright (the "Objection") [2]. The court considered the Motion and Objection at a hearing on February 3, 2009 (the "Hearing"). During the Hearing Debtors and the UST presented argument and the court heard testimony from William Snyder ("Snyder"), Debtors' Chief Restructuring Officer. At the conclusion of the Hearing, for reasons discussed below, the court invited Debtors and the UST to submit additional briefs by February 12, 2009. Both Debtors and the UST have submitted additional briefs. [3]

This contested matter is subject to the court's core jurisdiction. *28 U.S.C. §§ 1334* and *157(b)(2)(A)*. This memorandum opinion embodies the court's findings of fact and conclusions of law. *FED. R. BANKR. P. 7052* and *9014*.

I. Background

Debtors commenced these chapter 11 cases on December 1, 2008, by the filing of voluntary chapter 11 petitions. Debtors, the nation's second largest producer of chicken for sale in the consumer market, remain in possession of their estates and continue to operate their **[**4]** business.

At the time of commencement of these cases J. Clinton Rivers ("Rivers") was employed by the parent Debtor, Pilgrim's Pride Corporation ("PPC") as its Chief Executive Officer and Robert A. Wright ("Wright") was employed as PPC's Chief Operating Officer. Following commencement of these cases, the board of directors of PPC, based in part on Snyder's advice, determined that Debtors would be best served by a change in senior management. The board therefore entered into discussions with Don Jackson ("Jackson"), an individual who is knowledgeable and experienced in Debtors' industry. On December 16, 2008, PPC announced that Jackson would become Debtors' Chief Executive and Chief Operating Officer. By resignation **[*233]** agreements (the "Resignation Agreements") also dated December 16, 2008, Rivers and Wright resigned their respective offices. [4]

On January 2, 2009, Debtors filed the Motion. By the Motion Debtors seek, pursuant to *section 363(b)(1)* and/or *section 503(c)(3) of the Bankruptcy Code* (the "Code"), [5] to employ Rivers and Wright as consultants for four and three months respectively. [6] Under **[**5]** the proposed consulting agreements, Debtors will compensate Rivers and Wright at, essentially, their preresignation salaries. In the Objection, the UST argues that the proposed consulting agreements with Rivers and Wright violate Code *§ 503(c)(1)* and *(2)*. Even if the consulting agreements properly fall instead under *section 503(c)(3)*, the UST insists Debtors have failed to justify them as required by that section.

At the Hearing, Snyder testified that, in fact, Debtors do not require consulting services from either Rivers or Wright. [7] Rather, Snyder testified, the consulting

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[1] The Motion was filed at docket no. 427.

[2] The Objection was filed at docket no. 607.

[3] In his brief the UST raises the issue of whether parties were afforded due process respecting the Motion. The UST argues that the Motion mischaracterized the relief actually sought by Debtors (as discussed below) and, hence, parties did not have an opportunity to assess the true merits (or lack thereof) of the Motion. However, there is an active creditors' **[**3]** committee in these cases which monitored the Hearing and then and since has commented orally on the Motion. Neither it nor the several major secured creditors in these cases -- nor any other party in interest -- that was present at the Hearing has claimed lack of sufficient opportunity to evaluate or oppose the Motion. Moreover, if the Motion's emphasis was misplaced, the principal relief actually sought by Debtors was disclosed. Finally, the UST has vigorously contested the Motion such that the court is confident it has been made privy to the arguments against it. Accordingly, the court concludes no purpose would be served by requiring further notice and hearing prior to ruling on the Motion.

[4] Snyder testified at the Hearing that the resignations were in lieu of involuntary terminations.

[5] ***11 U.S.C. §§ 101 et seq.***

[6] The terms of the proposed consulting agreements are to run from the date of the order authorizing them.

[7] In their post-hearing brief, Debtors persist in the fiction that Rivers and Wright will, in fact, provide valuable assistance as consultants. It may be that Debtors are concerned about a provision of the Texas Business and **[**6]** Commerce Code cited by the UST and discussed below. However, the record

agreements are necessary to prevent Rivers and Wright from soliciting Debtors' customers on behalf of one of Debtors' competitors. Snyder testified that Jackson would need the period of the consulting agreements to establish his relationships with Debtors' customers.

Indeed, in response to a question from the court, Snyder affirmed that Debtors are not by the Motion trying to obtain the services of Rivers and Wright as consultants. Rather, Debtors seek court authority to purchase time-limited non-competition agreements from them.

Based on Snyder's testimony, the court was concerned that the issues -- under *section 503(c)* -- posed by the parties were not really the questions the court needed to address in deciding the Motion. The court thus asked Debtors and the UST to submit the additional briefs.

II. Discussion

The court has recharacterized the Motion as one by which Debtors seek authority essentially to purchase non-competition agreements from Rivers and Wright. The court's first task, then, is to determine whether the purchase by a debtor of a non-competition agreement from an insider (or one who was an insider at case commencement) conflicts with any of the provisions of Code *§ 503(c)*. If the court determines *section 503(c)* not to be a **[**7]** bar to the agreements, it must then decide whether such a transaction outside the ordinary course of business [8] should be authorized.

[*234] A. THE MOTION DOES NOT SEEK RELIEF INCONSISTENT WITH *SECTION 503(c)*.

Section 503(c) of the Code states:

(c) ***HN1***[] Notwithstanding subsection (b), there shall neither be allowed, nor paid--

(1) 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, **[**8]** absent a finding by the court based on evidence in the record that--

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either--

(i) The amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

(2) a severance payment to an insider of **[**9]** the debtor, unless--

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the

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before the court does not support the contention of Debtors that Rivers and Wright will perform meaningful consulting services for Debtors.

[8] In the Motion Debtors suggest that entry into consulting agreements would be part of the ordinary course of their business. Assuming, without deciding, that this would be true absent the pendency of a chapter 11 case (and that retention of a consultant would not ordinarily require court approval under Code *§ 327*), given the typical of the industry, creditor expectation test applied in determining ordinary course of business in chapter 11 (*see generally* 3 *Collier on Bankruptcy P 363.03[1]* (15th ed. Rev. 2005)), the court would not consider a purchase of a non-competition agreement, even coupled with a consulting agreement, to be an ordinary course of business transaction, at least on these facts for these Debtors.

benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

Section 503(c) was added to the Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). Section 503(c) was enacted to limit a debtor's ability to favor powerful insiders economically and at estate expense during a chapter 11 case. *See In re Airway Industries, Inc., 354 B.R. 82, 87 n.12 (Bankr. W.D. Pa. 2006)* (citing a statement by Senator Edward Kennedy quoted in the July 24, 2005, edition of the KANSAS CITY STAR); H.R. Rep. No. 109-031, pt. 1 at 84 (2005); 4 *Collier on Bankruptcy P 503.17* (15th ed. Rev. 2008).

In determining whether the Motion falls **[**10]** within section 503(c), the court must accord the statute its plain meaning. *See, e.g., Lamie v. United States Trustee, 540 U.S. 526, 534, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004)*; *United States v. Ron Pair Enters. Inc., 489 U.S. 235, 242, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989)*; *In re Nellson Nutraceutical, Inc., 369 B.R. 787, 801 (Bankr. D. Del. 2007)*.

[*235] ***HN2***[] *Section 503(c)(1)* applies to "a transfer made to, or an obligation incurred for the benefit of, an insider . . . for the purpose of inducing such person to remain with the debtor's business . . . ." This provision is directed at so-called key employee retention programs. *See* 4 *Collier on Bankruptcy P 503.17[1]* (15th ed. Rev. 2005).

Clearly, the purpose of the Motion -- and the payments to Rivers and Wright contemplated by it -- is not to cause Rivers and Wright "to remain with the [Debtors'] business." As Snyder testified, Debtors do not expect, as a result of the consulting agreements, that Rivers or Wright will have any meaningful role in Debtors' business. The purpose of the relief sought by the Motion is not to induce Rivers or Wright to remain with Debtors; it is simply to induce them *not* to work for a competitor of Debtors for a limited period of time. Indeed, the proposed consulting agreements include **[**11]** provisions both protecting against contact by Rivers and Wright with Debtors' customers and prohibiting Rivers and Wright during the agreements' terms from working for any of Debtors' competitors. *See* Rivers's *Consulting Agreement* at P 6(b) & (c) and Wright's *Consulting Agreement* at P 6(b) & (c). Because the proposed consulting agreements are not for the purpose of retaining Rivers and Wright, section 503(c)(1) has no application here.

HN3[] *Section 503(c)(2)* bars "a severance payment to an insider of the debtor . . ." unless the payment is in accordance with the tests set out in that section. The evidence before the court is that both Rivers and Wright have been paid severance as permitted by section 503(c)(2). [9] The payments proposed by the Motion are not intended as severance, nor do they have more than a tangential relationship to the termination of Rivers and Wright. The court does recognize that, ***HN4***[] if a debtor may pay a terminated insider not to compete, the result may be that debtors will seek to evade section 503(c)(2)'s limit on severance pay through negotiation of a noncompetition agreement. [10] However, any such agreement will still require court approval under (as discussed below) **[**12]** *section 503(c)(3)*, and an agreement which is clearly improvident or a subterfuge will not receive such approval.

The UST, however, points to *In re Dana Corporation, 351 B.R. 96, 102-3 (Bankr. S.D.N.Y. 2006)*, in which the bankruptcy court ruled that payments ostensibly in exchange for a non-competition agreement **[**13]** were in fact tied to the employee's severance and so were barred by section 503(c)(2). *Dana* is distinguishable in that it involved a pre-termination agreement, unlike the post-severance agreement in the case at bar. The covenant not to compete part of the agreement in *Dana* was included with the severance terms. This resulted in a clear interrelationship between the proposed payments and the potential of **[*236]** the employee's severance. Moreover, the ruling of the *Dana* court was based on the failure of the debtors "to meet their burden of demonstrating that the payments in exchange for signing a non-compete agreement . . . [did] not

[9] The UST argues that Debtors overpaid severance to Rivers and Wright. The difference between Debtors' and the UST's calculation of the permitted severance depends on how "a calendar year" is determined for purposes of section 503(c)(2)(B). *See* 4 *Collier on Bankruptcy P 503.17[2]* (15th ed. Rev. 2005). The court need not address this issue at this time.

[10] It is not uncommon to see an employment agreement with an insider that includes, in connection with specified severance payments, a noncompetition provision. Of course, such an agreement is only enforceable in a chapter 11 context by the insider as permitted by section 503(c). The court questions (though in the instant case it need not decide) whether a noncompetition provision in an employment agreement would be enforceable by a debtor if the severance provisions of the agreement are otherwise not enforceable against the debtor.

constitute 'severance' for purposes of section 503(c)(2) . . . ." *Id.* The court here would find Debtors have met any burden they may have to prove the payments to Rivers and Wright are not for severance. The court thus holds that the proposed consulting agreements do not violate section 503(c)(2).

Section 503(c)(3) on its face applies to the relief sought by the Motion. **HN5**[] The provision is not plainly limited in its scope even to transactions with insider employees, though its final clause ("including transfers made to . . . officers, managers, or consultants hired **[**14]** after" case commencement) together with the balance of section 503(c) suggest that was its intended focus. However, the court need not at this juncture decide whether section 503(c)(3) was intended to reach beyond transactions with insiders. Whether or not section 503(c)(3) is of broader scope, **HN6**[] it clearly would apply to any "transfer[ ] or obligation[ ] [to an insider] that [is] outside the ordinary course of business." As the Motion proposes transfers and obligations to insiders [11] that are outside the ordinary course of business, section 503(c)(3) applies to the Motion.

Section 503(c)(3), however, does not prohibit such a transfer or obligation. Rather, it conditions approval of a proposed transfer or obligation upon such being "justified by the facts and circumstances of the case." If Debtors have made a showing that the payments to Rivers and Wright proposed in the Motion are so justified, the relief sought by the Motion is not inconsistent with section 503(c)(3).

B. THE STANDARD FOR GRANTING RELIEF.

Debtors argue that the test for granting the Motion should be that of the business judgment rule as applied under Code § 363(b)(1). They cite several cases, [12] including *Dana*, in support of the proposition that section 503(c)(3) requires no different standard than that applied under the former provision. Motion, PP 10-11. On the other hand, some courts have held that section 503(c)(3) sets a higher bar than the simple business judgment test. *See* *In re CEP Holdings, LLC, 2006 Bankr. LEXIS 3305 *8-9 (Bankr. N.D. Ohio 2006)*; *In re Dura Auto Sys, Inc., Case No. 06-11202, Docket No. 1369, 2007 Bankr. LEXIS 4679 (Bankr. D. Del. June 29, 2007)*; *In re Supplements LT, Inc.,* **[**16]** *Case No. 08-10446 (KJC), Docket No. 227, 2008 Bankr. LEXIS 3777 (Bankr. D. Del. Apr. 14, 2008)*.

The court agrees with the conclusion reached in this latter group of cases that **HN8**[] the test of section 503(c)(3) should not be equated to the business judgment rule as applied under section 363(b)(1). First, to do so would mean that section 503(c)(3) **[*237]** is redundant. A transfer made or an obligation incurred outside the ordinary course of a debtor's business would fall within section 363(b)(1) in the absence of section 503(c)(3), and, thus, the latter provision would add nothing to the Code. Congress is presumed to intend that independent sections of the Code will have independent, differing impacts. *See, e.g.,* *BFP v. Resolution Trust Corp., 511 U.S. 531, 537, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994)*. To read section 503(c)(3) as requiring nothing not already required by section 363(b)(1) would violate this principle of construction.

Second, the conditioning of approval of covered transfers and obligations **[**17]** upon their being "justified by the facts and circumstances of the case" suggests to the court that Congress intended the court to play a more critical role in assessing transactions, at least those with insiders, that fall within the ambit of section 503(c)(3). In applying the simple business judgment test, courts are adjured to defer to the debtor in possession or trustee; if a valid business reason is shown for a transaction, the transaction is to be presumed appropriate. *See* 7 *Collier on Bankruptcy P 1108.06* (15th ed. rev. 2006).

The court concludes that **HN9**[] section 503(c)(3) is

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[11] **HN7**[] An insider is defined as including directors and officers of a corporate debtor. ***11 U.S.C. Code § 101(31)(B)*** (2009). As their employment by Debtors has been terminated, and Rivers and Wright are thus no longer officers (though the court is unclear whether either is still a director of any of Debtors), they arguably are not insiders. Such a reading of the statute would surely frustrate Congress's intent in BAPCPA in enacting section 503(c). As the definition of insider is inclusive, the court therefore holds that, for purposes of section 503(c), anyone who was an officer or director of a debtor as of commencement of **[**15]** the debtor's bankruptcy case is an insider.

[12] *See* *In re Nobex, Case No. 05-20050, Docket No. 194 (pp. 86-87), 2006 Bankr. LEXIS 417 (Bankr. D. Del. Jan. 19, 2006)*; *see also* *In re Riverstone Networks, Inc., Case No. 06-10110, 2006 Bankr. LEXIS 4630 (Bankr. D. Del. Mar. 28, 2006)*; *In re Pliant Corp., Case No. 06-10001, 2006 Bankr. LEXIS 4631 (Bankr. D. Del. Mar. 14, 2006)*.

intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it. The court reads this requirement as meaning that the court must make its own determination that the transaction will serve the interests of creditors and the debtor's estate. Put another way, when a transaction is proposed between a debtor and its insiders, the court cannot simply rely on the debtor's business judgment to ensure creditors and the debtor's estate are being properly cared for. Given **[**18]** the obvious conflict of interest between a debtor's estate and insiders -- who may themselves have been responsible in whole or part for devising and internally approving the proposed transaction -- the argument underlying application of the business judgment rule (that officers and directors will fulfill their fiduciary responsibilities) lacks its usual weight. Reading section 503(c)(3) as does the court therefore clearly comports with the other two subdivisions of section 503(c) and suits the evident purpose of Congress in enacting the provision. [13]

C. APPLICATION TO THE MOTION.

The court concludes that, on the record before it, Debtors have carried their burden of showing that the proposed agreement is justified by the facts and circumstances of the case. Not only **[**19]** does Snyder's testimony underwrite a valid business reason for the agreements with Rivers and Wright, his testimony also demonstrates that entry into the agreements is in the best interests of creditors and Debtors' estates. [14]

[*238] Without the agreements proposed in the Motion, Debtors will be subject to potential competition **[**20]** engineered by Rivers and Wright. Debtors assert they have no right to prevent that competition as things stand. [15] Snyder's testimony, which the court finds credible, [16] was that Rivers and Wright were knowledgeable about Debtors' customers and had contacts with those customers, and that either might use such knowledge and contacts to divert those customers to one of Debtors' competitors. According to Snyder, diversion of even one of Debtors' largest customers could cost Debtors hundreds of millions of dollars. While the payments to Rivers and Wright will be substantial -- totaling almost $ 500,000 -- the cost of the agreements with these individuals is miniscule in comparison with the extent of Debtors' business [17] and the harm that might be done to Debtors' reorganization prospects and estates if the Motion is not granted and Debtors' fears respecting competition through Rivers and Wright are realized.

Courts in the past have authorized debtors to pay

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[13] That the court should assess the value to the debtor of a post-petition transaction covered by section 503(c)(3) is also consistent with another provision added by BAPCPA and directed toward the incestuous relationship between a debtor and its insiders, ***section 548(a)(1)(B)(ii)(IV)***, providing that prepetition transactions with insiders will be subject to avoidance if the debtor did not receive reasonably equivalent value.

[14] The court does not here address whether Debtors might have struck a better deal with Rivers and Wright. The court, like the UST, is troubled by the cost of what amounts to agreements not to compete which will be effective for only a brief period of time. However, the court need only determine that Debtors have provided a sound business reason for the agreements and that, even at their projected cost, the benefit to creditors and Debtors' estates is of commensurate value. Moreover, there is no evidence in the record (other than the tenuously circumstantial suggestion of the correspondence between the proposed payments to Rivers and Wright and their prior salaries) that negotiation of the proposed consulting agreements was not arms length. In fact, the record suggests Snyder, who, as discussed below, has a degree of independence, was an active participant in the negotiations.

[15] The UST argues that Rivers and Wright are, in any event, effectively barred by the Resignation Agreements from stealing Debtors' customers. The court addresses this argument below.

[16] Though technically Debtors' employee, Snyder serves as Debtors' Chief Restructuring Officer and so **[**21]** is more like an independent advisor. In fact, Snyder was retained by order of the court. *See Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code for Authorization to (A) Employ and Retain CRG Partners Group LLC to Provide the Debtors a Chief Restructuring Officer and Additional Personnel, and (B) to Designate William Snyder as the Chief Restructuring Officer for the Debtors Nunc Pro Tunc to the Commencement Date* entered in this case on January 9, 2009 at Docket no. 825. The court has had considerable experience with Snyder in prior cases (*see, e.g.,* In re Mirant Corp., 354 B.R. 113, 120 (Bankr. N.D. Tex. 2006)). Taking that experience into account, the court is confident that Snyder testified truthfully about the proposed agreements and the reasons motivating them. The court additionally is prepared to infer, as it does below, that Snyder ensured Debtors and their counsel engaged in appropriate due diligence in evaluating the agreements.

[17] Debtors' annual revenues exceed $ 8.5 billion. Debtors' Form 10-K for the fiscal year ending Sept. 27, 2008, filed Dec. 11, 2008, at p. 55.

former insiders not to compete with them. *See,* ***[**22]*** *e.g., In re Werner Holding Co, Inc., et al., Case No. 06-10578, 2006 Bankr. LEXIS 4049 (Bankr. D. Del. 2006)*; *In re Footstar, et al.,* Case No. 04-22350 (Bankr. S.D.N.Y. Dec. 20, 2004). Thus there is no categorical prohibition on payments by a debtor to an insider to prevent competition.

The UST, however, makes two arguments for why the court should deny the Motion notwithstanding Snyder's testimony. First, the UST argues that the agreements will not be enforceable by reason of *section 15.50(a) of the Texas Business and Commerce Code*. Second, the UST insists that, in any event, Rivers and Wright may not solicit Debtors' customers on behalf of a competitor because of the provisions of their Resignation Agreements.

TEX. BUS & COMM. CODE § 15.50(a) states (in pertinent part):

> (a) ***HN10***[] Notwithstanding Section 15.05 of this code, and subject to any applicable provision of Subsection (b), a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the **[*239]** agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect **[**23]** the goodwill or other business interest of the promisee.

TEX. BUS & COMM. CODE § 15.50(a). From this statute the UST argues that, since the agreements with Rivers and Wright are intended only to protect Debtors from competition, the noncompetition portions of the agreements are not "ancillary to or part of . . . otherwise enforceable agreement[s]."

This argument fails for two reasons. First, while Debtors may not intend to enforce the consulting portions of the agreements, that does not mean they could not do so. ***HN11***[] *Section 15.50(a)* requires only that the agreement be enforceable, not that it be -- or, from the promisee's perspective, that it be intended to be -- actually enforced.

Second, ***HN12***[] *section 15.50(a)* is intended primarily to protect the promissor -- i.e., the party promising not to compete -- not the beneficiary of the covenant not to compete -- here the Debtors. *See Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson, 209 S.W.3d 644, 650-51 (Tex. 2006)* (requiring performance by the employer for a non-compete agreement to be enforceable). Thus, the fact that the agreements will be enforceable against Debtors (the agreements will be entered pursuant to this court's order, [18] so they will **[**24]** be enforceable), means they satisfy *section 15.50(a)*.

The UST next argues that Debtors do not need the covenants not to compete from Rivers and Wright as embodied in the proposed agreements. Leaving aside the UST's assertion that the record does not support Debtors' contention that Wright could divert any of Debtors' customers, [19] the court is not prepared at this point and in this context to construe the obligations of Rivers and Wright under the Resignation Agreements. In the first place, the court's construction of those agreements in the context of the Motion might not be binding on Rivers and Wright. Second, the court infers from Snyder's testimony that he -- and Debtors -- considered whether the Resignation Agreements sufficiently protected **[**25]** Debtors. The court is confident that counsel to Debtors would not have presented the Motion to the court without analyzing its legal justification. [20] Consideration of the legal **[*240]** effect of the severance agreements would be an essential part of the due diligence that would be a

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[18] The court is also not persuaded that a Texas statute precludes entry by a debtor into an agreement blessed by order of a federal court. But, as the state statute here is in any event satisfied, the court need not look to the *Constitution's supremacy clause* as warrant for approval of the proposed agreements. Cf. *U.S. Const. art. VI, cl. 2*; *New York v. United States, 505 U.S. 144, 159, 112 S. Ct. 2408, 120 L. Ed. 2d 120 (1992)*; *In re Ferguson, 112 B.R. 820 (Bankr. N.D. Tex. 1990)*.

[19] Even if the court were not satisfied that Snyder's testimony regarding Wright was sufficient, it is improbable that Wright, Debtors' chief operating officer, would not be well-acquainted with Debtors' principal customers and have frequent communication with those customers.

[20] The **[**26]** Resignation Agreements do provide considerable protection for Debtors' confidential information, including a provision barring each of Rivers and Wright from "disclos[ing] . . . directly or indirectly" "customer contacts and information." Resignation Agreements, P 6. While the court agrees with the UST that this provision, at least, may give Debtors protection against the conduct the Motion is intended to prevent, the court can also justify a construction that would not prevent Rivers and Wright from using their knowledge of Debtors' customers to Debtors' detriment. Given the potential consequences of competition from Rivers or Wright, the court cannot conclude Debtors are wrong in seeking absolute

necessary prerequisite to filing the Motion. [21] That Debtors *might* be protected adequately by the terms of the Resignation Agreements is not alone sufficient to warrant the court's second guessing of Debtors' decision to purchase the additional and iron-clad assurance against competition afforded by the agreements proposed in the Motion [22]. Nevertheless, the court cautions Debtors and their counsel that it will take submission of an order granting the Motion as constituting verification of the court's assumption that counsel has assessed fully the legal necessity to the protection of Debtors' business of the proposed consulting agreements.

III. Conclusion

For the foregoing reasons, the Objection is overruled and the Motion will be GRANTED. Counsel to Debtors may present an order to such effect.

The following constitutes the ruling of the court and has the force and effect therein described.

Signed February 26, 2009

/s/ D. Michael Lynn

United States Bankruptcy Judge

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certainty that such competition will not occur. The court nevertheless notes that in granting the Motion, it does not intend to in any way limit or reduce the obligations of Rivers and Wright under their Resignation Agreements.

[21] The court cannot believe Debtors' counsel and Snyder would risk their respective reputations -- to say nothing of their fees -- in order to rubber-stamp the gift of funds to Rivers and Wright.

[22] On a different record, especially given the court's role under section 503(c)(3), **[**27]** it might be appropriate to deny relief in a case like that at bar on the basis that the debtor's decision-making process or due diligence was flawed.

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Trump Entertainment Resorts, 3rd Cir.(Del.), January 15, 2016

477 B.R. 378
United States Bankruptcy Court,
S.D. New York.

In re HOSTESS BRANDS, INC., Debtors.

No. 12–22052 (RDD).
|
June 22, 2012.

Synopsis
Background: Chapter 11 debtor moved to reject its collective bargaining agreements (CBAs), and labor unions moved to dismiss on jurisdictional grounds because the CBAs had expired prepetition.

[Holding:] The Bankruptcy Court, Robert D. Drain, J., held that bankruptcy statute permitting Chapter 11 debtor-in-possession to assume or reject collective bargaining agreement (CBA) only in accordance with provisions of that statute, by its plain terms, did not apply to CBAs that had expired prepetition, though, pursuant to terms of the National Labor Relations Act (NLRA), certain terms of these CBAs remained in effect.

Unions' motion granted.

West Headnotes (3)

[1] **Bankruptcy**
Collective bargaining agreements

Bankruptcy statute permitting Chapter 11 debtor-in-possession to assume or reject collective bargaining agreement (CBA) only in accordance with provisions of that statute, by its plain terms, did not apply to CBAs that had expired prepetition, though, pursuant to terms of the National Labor Relations Act (NLRA), certain terms of these CBAs remained in effect until the parties, in good faith, had bargained to impasse; term "collective bargaining agreement" could not be interpreted expansively to refer not just to collective bargaining agreement as contract but to debtor's obligations under the CBA, except in that subsection of statute applicable "during a period when the collective bargaining agreement continues in effect." 11 U.S.C.A. § 1113; National Labor Relations Act, § 1 et seq., 29 U.S.C.A. § 151 et seq.

7 Cases that cite this headnote

[2] **Bankruptcy**
Collective bargaining agreements
Bankruptcy
Partial assumption;burdens and benefits

Collective bargaining agreement that had expired prior to commencement of debtor's Chapter 11 case, and only certain provisions of which remained in effect, pursuant to terms of the National Labor Relations Act (NLRA), until the parties, in good faith, had bargained to impasse, could not be assumed, as contracts can be assumed only in toto. 11 U.S.C.A. § 1113(a); National Labor Relations Act, § 1 et seq., 29 U.S.C.A. § 151 et seq.

5 Cases that cite this headnote

[3] **Bankruptcy**
Collective bargaining agreements

Collective bargaining agreement that cannot be assumed also cannot be rejected. 11 U.S.C.A. § 1113(a).

4 Cases that cite this headnote

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MODIFIED BENCH RULING ON THE MOTION OF THE BAKERY, CONFECTIONARY, TOBACCO WORKERS AND GRAIN MILLERS INTERNATIONAL UNION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION

ROBERT D. DRAIN, Bankruptcy Judge.

I have before me the motion of the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union —or the Bakers' Union—to dismiss the 1113/1114 motion of the debtor for lack of subject matter jurisdiction.

The motion is premised upon the Bakers' Union's view of the plain language of Section 1113 of the Bankruptcy Code, which is the sole source to permit the rejection of a collective bargaining agreement by the bankruptcy court.

[1] The statute provides, in relevant part in Section 1113(a), that "The debtor in possession may assume or reject a collective bargaining agreement only in accordance with the provisions of this section." Sections (b) through (d)—or subsections (b) through (d) of Section 1113, then set forth the criteria and process for a debtor in possession's rejection of a collective bargaining agreement.

And then Section 1113(f) provides that "no provision of this title shall be construed to permit a trustee"— which is defined in Section 1113(a) as also including a debtor in possession—"to unilaterally terminate or alter any provisions of a collective ***380** bargaining agreement prior to compliance with the provisions of this section."

In each instance of the sections that I've quoted the statute refers to a "collective bargaining agreement." The Bakers' union asserts that now that its identified collective bargaining agreements have expired, they are not viewed under the law as "agreements," but, rather, they are viewed as setting forth terms that remain, in part, in effect until the parties, in good faith, bargain to impasse, at which point those terms are no longer in effect under the NLRA, subject, of course, to either party's right to seek a determination from the NLRB, and then, ultimately, through the court process, that the other side had not bargained in good faith to impasse.

The Bakers' union contends—and I agree with it—that, technically speaking, that regime, that post-expiration regime is not one in which the collective bargaining agreement itself governs, but, rather, that the NLRB governs in a way that leaves key provisions, but not all of the provisions, of the collective bargaining agreement in effect under the law.

The debtors contend that in drafting Section 1113(a) through (d) and 1113(f) Congress meant more than simply that collective bargaining agreement *as a contract,* but also any of the debtor's *obligations* under that agreement, including obligations to perform according to the terms of the provisions of such agreement that are required to be performed under the NLRA until good faith bargaining to impasse.

Both sides have argued their positions effectively and, frankly, there is considerable merit to each position. The case law in this area is far from controlling. Both sides have cited decisions that favor their respective positions. The debtors rely, as far as decisions on point, primarily upon *In re Karykeion, Inc.,* 435 B.R. 663 (Bankr.C.D.Cal.2010).

In that decision Bankruptcy Judge Tighe agrees with the debtor's view that the interpretation that the Bakers' Union would impose on the statute would impermissibly leave a debtor at the mercy of a non-bankruptcy court-supervised—and, necessarily, under the statute— rapid bargaining and decision-making process, instead subjecting them to the uncertainties of what Judge Tighe refers to as "the more formal bargaining process" under the NLRA, as informed by the risk of after-the-fact sanction under Sections 8(a) and 8(d) of the NLRA.

The Karykeion opinion concludes that Congress must not have meant to subject a debtor to that process when, in essence, the key provisions of the collective bargaining agreement are still in effect post-expiration. In support of that view, Judge Tighe cites, as do the debtors, Section 1113(e) of the Bankruptcy Code which states, "If, during a period when the collective bargaining agreement continues in effect and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court, after notice and a hearing, may authorize the trustee to implement interim changes in the terms, conditions, wages and benefits or work rules provided by a collective bargaining agreement. Any hearing under this paragraph shall be scheduled in accordance with the needs of the trustee. The implementation of such interim changes shall not render the application for rejection moot."

Judge Tighe points out that the phrase "when the bargaining agreement continues in effect" in Section 1113(e) could easily be read to contemplate that the terms of the agreement remain in effect or terms of the agreement as opposed to the agreement remain in effect, which arguably is a fair ***381** layman's summary of what happens after the expiration of a collective bargaining agreement.

That view is buttressed by the fact that Subsection 1113(e) refers to alterations only in respect of conditions waived as benefits or work rules which, at least based on my understanding, would be the types of provisions that would be viewed as carrying on after expiration until good faith bargaining to impasse.

The other decision relied upon by the debtor dealing with a similar fact pattern is *In re Ormet Corp.,* 316 B.R. 662 (Bankr.S.D.Ohio 2004), in which the court concluded, where the 1113 process started, as it did here, with agreements still in effect and the agreements subsequently expired before the process ended, "The debtors should not be penalized for their diligent efforts over the course of several months to make a proposal based on the most complete and reliable information available, and to provide the parties with all necessary information to evaluate that proposal. The statute requires far less. The debtors also should not have to risk being charged with an unfair labor practice by declaring an impasse and unilaterally making changes to the terms and conditions of the parties' agreements without this Court approval." 316 B.R. at 665.

Both of those decisions assume without any real evidence that there would, in fact, be a material difference in the time within which a debtor could get comfort that the proposed new terms for a collective bargaining agreement could, in fact, be enforced without the risk of sanction. They also assume, without any real evidence, that the uncertainty of a subsequent NLRB determination and an inevitable litigation—which would probably end up with a litigation at the federal court level under Section 8(a) or 8(d) of the NLRA—would so chill the debtor's reorganization efforts and, in particular, the debtor's efforts to raise exit financing or close a transaction necessary to preserve the debtor's going concern value that Congress would have meant when it referred to "a collective bargaining agreement" in Sections 1113(a) through (d) and (f) that it includes the collective bargaining agreement [in effect] after its expiration.

It is not clear to me that, in fact, that would be the case, however. Obviously, Congress imposed a rapid bargaining process which, if the parties—or one party—does not pursue in good faith and which otherwise satisfies the requirements of Section 1113 will lead to a court order permitting the rejection of the collective bargaining agreement. And, intuitively, I feel that the bargain to impasse process outside of the 1113 process, under the NLRA, could well be more lengthy or create more risk of uncertainty for prospective investors or acquirers of the debtors as a going concern. But it is at this level only an intuition. The debtor has not offered evidence on this issue. It is a fact issue that for example, may lead to a different result as between the NLRA and the RLA.

What is clear to me is that Congress created a sui generis provision in Section 1113. As noted by the Second Circuit in *In re Northwest Airlines Corp.,* 483 F.3d 160 (2d Cir.2007), the purpose of Section 1113 is different from the statutory construct of Section 365 of the Bankruptcy Code. It is a self-contained provision. Thus, as interpreted by the Second Circuit in the Northwest Airlines case, it provides for the abrogation of a collective bargaining agreement, if the court grants the debtor's motion, which if it's not on a consensual basis means that the union does not have a breach claim, given that there is no provision of Section 1113 that provides for such a claim and Sections 365 ***382** and 502(g) govern only rejections of current contracts under Section 365.

The debtor's "policy and purpose" argument, therefore, I believe is a stretch here. Clearly, there is a unique purpose to Section 1113, and that unique purpose is intended to provide for expedited, good faith bargaining and, ultimately, a determination by the court, if that doesn't occur. But I do not necessarily read in the statute a purpose extending it beyond the collective bargaining agreement itself to discreet provisions of the agreement that would remain, under the law, although not under the agreement itself, in effect post-expiration.

In fact, I view the language in Section 1113(e) to create a distinction between provisions that continue in effect and the agreement as a whole. In construing the statute, it would appear to me to be more reasonable to view Section 1113(e) as an exception to Section 1113's other provisions that generally focus on the contract itself and not on term that would be in effect, except for instances, as set forth in 1113(e), where, if it is essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court may authorize, on an interim basis, the implementation of interim changes to terms, conditions, waives, benefits or work rules.

There are two cases, including one from this district, that come very close to taking that view. (Of course, one can distinguish each of them, as I'll point out in a moment.)

But in both *In re Chas. P. Young Company,* 111 B.R. 410 (Bankr.S.D.N.Y.1990) and *In re D.O. & W. Coal Company,* 93 B.R. 454 (Bankr.W.D.Va.1988), the court concluded that orders under 1113(e) could continue to apply after the expiration of the collective bargaining agreement. Now in each of those cases the court had already entered the order, so one could distinguish those cases from the present facts in saying that the court was continuing to implement an order that the parties had relied upon. But I believe the rulings go beyond that, particularly Judge Blackshear's ruling in the Chas. P. Young case. I do so particularly because in that case he recognized, consistent with pre-Section 1113 case law (but of course this was after the event under Section 1113) that "rejection of the collective bargaining agreement pursuant to Section 1113(b) and (c) is a moot issue if the agreement expires by its own terms and before the bankruptcy court has a hearing on rejection."

He was not alone in reaching that conclusion. It was also reached after the enactment of Section 1113, albeit in dicta, by the Ninth Circuit Bankruptcy Appellate Panel in *In re San Rafael Baking Company,* 219 B.R. 860 (9th Cir. BAP 1998). And it is stated by the editors of *Colliers,* albeit that they rely upon some pre-Section 1113 authority as well, that this is the majority view. 7 Collier on Bankruptcy ¶ 1113.02[1][d] (16th ed. 2011).

But my conclusion here is not a matter of toting up the cases that take the Bakers' union's view of the matter here and comparing them against the number of cases that take the debtor's view.

My conclusion instead is based first on the plain language of Section 1113 as a whole and the distinction between 1113(e) and 1113(a) through (d) and (f); and, secondly, my view that, given the importance of Section 1113 and its visibility and the visibility of the issues it relates to, I believe that Congress should be viewed as going only as far as the plain language takes it in this section, and that I should not presume to extend the language in the way that the debtor asks to do to further a policy concern, particularly where, again, ***383** the facts allegedly supporting that policy argument are, I believe, on this record no more than convincing at a merely intuitive level.

I believe if I were to extend the language of "collective bargaining agreement" to "collective bargaining agreement in effect" or "collective bargaining agreement as it covers the relations between the parties," I would be basing that conclusion on, first, a policy that is not well-articulated or found in the statute itself. Secondly, I'm of a view that as a factual matter I do not believe it has been established that the post-expiration regime would so interfere with whatever the congressional policy is behind Section 1113 as to the negate, Congress's policy. This result might be different if the CBAs were governed by the RLA. *See* 7 Collier on Bankruptcy at ¶ 1113.07[1][d]. And, finally, I believe it would stretch the statute's language too far.

[2] **[3]** As noted during oral argument, only certain provisions of the collective bargaining agreement remain in effect by operation of the NLRA. So it appears to me that, absent consent, the agreement could not be *assumed,* since it can only be assumed in toto, again, unless the parties agree to amend it, and it is logical that an agreement that cannot be assumed under Section 1113(a) (which uses the phrase "assume or reject"), also cannot be rejected under Sections 1113(a) and (c),

Given the expiration of the agreement, I believe that 1113 instead leaves the parties (except, I believe, under 1113(e)) under the fallback provisions of otherwise applicable law, including here, the NLRA.

Courts have found at times that that fallback regime may assist the debtor in relieving the debtor of certain claims. *See,* for example, *In re CF & I Fabricators of Utah Inc.,* 163 B.R. 858 (Bankr.D.Utah 1994). appeal dismissed, 169 B.R. 984 (D.Utah 1994), but I don't believe Congress intended in this provision, and certainly not consistent with the plain language of the provision, to impose the rejection process on parties to an already expired agreement.

As the debtors have noted, and as the Second Circuit has noted in the Northwest case, except for its expedited time frame, the requirements of Section 1113(a) through (d) contemplate bargaining in good faith to impasse along with additional requirements going to the reorganization and the equities. Those requirements, at least the bargaining in good faith to impasse, I believe are in complete overlap with the NLRA process. I find it hard to believe that, as a legal matter, the NLRB and any reviewing court would not take into account the context in which the debtors and the Bakers' locals find themselves, including the effect of uncertainty and the need for a quick resolution in order to obtain exit financing for an acquirer's agreement to preserve the debtors as a going concern as opposed to having a liquidation.

And for that reason, again, it is hard for me to find such a clear dichotomy between the process that the union says must apply here and what the debtor contends Congress intended to apply under Section 1113 to require that 1113 would apply even when an agreement has expired.

So, for those reasons, I will grant the Bakers' unions' motion and, Mr. Freund, you can submit an order consistent with that ruling.

All Citations

477 B.R. 378, 67 Collier Bankr.Cas.2d 1883

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In re Trump Entm't Resorts Unite Here Local 54

United States Court of Appeals for the Third Circuit

March 4, 2015, Argued; January 15, 2016, Opinion Filed

No. 14-4807

Reporter

810 F.3d 161 *; 2016 U.S. App. LEXIS 672 **; 205 L.R.R.M. 3201; 166 Lab. Cas. (CCH) P10,842; 74 Collier Bankr. Cas. 2d (MB) 1656; 62 Bankr. Ct. Dec. 3; Bankr. L. Rep. (CCH) P82,909

IN RE: TRUMP ENTERTAINMENT RESORTS UNITE HERE Local 54, Appellant

Subsequent History: US Supreme Court certiorari denied by *Unite v. Trump Entm't Resorts, 2016 U.S. LEXIS 3575 (U.S., May 31, 2016)*

Prior History: **[**1]** On Appeal from the United States Bankruptcy Court for the District of Delaware. (D. Del. Bankruptcy No. 14-12103). Bankruptcy Judge: Honorable Kevin Gross.

In re Trump Entm't Resorts, Inc., 519 B.R. 76, 2014 Bankr. LEXIS 4439 (Bankr. D. Del., 2014)

Core Terms

expired, bankruptcy court, reorganization, terms, bargaining, obligations, contributions, negotiations, employees, collective bargaining agreement, Casino, modifications, provisions, modify, terms and conditions, liquidation, terminate, unexpired, parties, pension, executory contract, conditions, unilateral, contracts, Resorts, changes, impasse, new agreement, requirements, burdensome

Case Summary

Overview

HOLDINGS: [1]-The bankruptcy court properly granted the debtors' motion to reject their collective bargaining agreement with the union pursuant to 11 U.S.C.S. § 1113(c) because § 1113 did not distinguish between the terms of an unexpired collective bargaining agreement and the terms and conditions that continued to govern after the collective bargaining agreement expired.

Outcome

Judgment affirmed.

LexisNexis® Headnotes

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN1 **Conversion & Dismissal, Reorganizations**

Section 1113 of the Bankruptcy Code allows a Chapter 11 debtor to reject its collective bargaining agreements under certain circumstances. 11 U.S.C.S. § 1113. The National Labor Relations Act (NLRA) prohibits an employer from unilaterally changing the terms and conditions of a collective bargaining agreement even after its expiration. *29 U.S.C.S. § 158(a)(5)*. Thus, under the NLRA, the key terms and conditions of an expired collective bargaining agreement continue to govern the relationship between a debtor-employer and its unionized employees until the parties reach a new agreement or bargain to impasse.

Business & Corporate Compliance > ... > Collective Bargaining & Labor Relations > Unfair Labor Practices > Employer Violations

HN2 **Unfair Labor Practices, Employer Violations**

An employer commits an unfair labor practice if, without bargaining to impasse, it unilaterally changes existing terms or conditions of employment.

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

HN3[] Standards of Review, De Novo Standard of Review

The appellate court reviews the bankruptcy court's legal determinations de novo.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN4[] Conversion & Dismissal, Reorganizations

11 U.S.C.S. § 1113 allows the debtor only to terminate or modify its ongoing obligations to its employees; it does not give a bankruptcy court the authority to interpret or administer the National Labor Relations Act. This is a no greater intrusion on the National Labor Relations Board's jurisdiction than if the court were to apply § 1113 to a collective bargaining agreement which has not expired by its terms.

Governments > Legislation > Interpretation

HN5[] Legislation, Interpretation

The court's role in interpreting a statute is to give effect to Congress's intent. Because courts presume that Congress expresses its intent through the ordinary meaning of its language, a court begins its analysis by examining the plain language of the statute. When statutory language is plain, the sole function of the courts, at least where the disposition required by the text is not absurd, is to enforce it according to its terms.

Governments > Legislation > Interpretation

HN6[] Legislation, Interpretation

A mere divergence in statutory construction does not render a statute ambiguous. Instead, the court must determine whether the statute is ambiguous by examining the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.

Bankruptcy Law > Business & Corporate Compliance > Bankruptcy

Governments > Legislation > Interpretation

HN7[] Bankruptcy Law

In interpreting the Bankruptcy Code, the United States Supreme Court has been reluctant to declare its provisions ambiguous, preferring instead to take a broader, contextual view, and urging courts to 'not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy. A provision is ambiguous, when, despite a studied examination of the statutory context, the natural reading of a provision remains elusive. In that case, and as a last resort, the court turns to pre-Code practice and legislative history to find meaning.

Governments > Legislation > Interpretation

HN8[] Legislation, Interpretation

Often times the meaning, or ambiguity, of certain statutory words or phrases may only become evident when placed in context.

Bankruptcy Law > Business & Corporate Compliance > Bankruptcy

Governments > Legislation > Interpretation

HN9[] Bankruptcy Law

Statutory construction is a holistic endeavor, and this is especially true of the Bankruptcy Code.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN10[] Conversion & Dismissal, Reorganizations

Section 1113 of the Bankruptcy Code governs the means by which a debtor may assume, reject, or modify a collective bargaining agreement. It establishes an expedited negotiation process for modifying a collective bargaining agreement and allows for judicial evaluation of a petition to reject a collective bargaining agreement if negotiations are unsuccessful. Specifically, *11 U.S.C.S. § 1113* provides that a debtor may reject a collective bargaining agreement if the bankruptcy court determines that (1) the debtor has made a proposal to its employees which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization, (2) the authorized representative of the employees has refused to accept such proposal without good cause, and (3) the balance of the equities clearly favors rejection of such agreement. *§ 1113(a)*, *(b)(1)*, *(c)*. *Section 1113* explicitly forbids debtors from terminating or altering any provisions of a collective bargaining agreement prior to compliance with the provisions of *§ 1113*. *§ 1113(f)*.

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN11[] Collective Bargaining & Labor Relations, Enforcement of Bargaining Agreements

The National Labor Relations Act requires that once a collective bargaining relationship has been established, an employer may not make a change affecting the mandatory bargaining subjects without affording the union the opportunity to bargain over the change. Even when a collective bargaining agreement expires, the employer must maintain the status quo with respect to mandatory subjects of bargaining until it either enters into a new contract or bargains to impasse.

Business & Corporate Compliance > ... > Labor & Employment Law > Collective Bargaining & Labor Relations > Duty to Bargain

Business & Corporate Compliance > ... > Collective Bargaining & Labor Relations > Unfair Labor Practices > Employer Violations

HN12[] Collective Bargaining & Labor Relations, Duty to Bargain

29 U.S.C.S. § 158(a)(5) provides that it shall be an unfair labor practice for an employer to refuse to bargain collectively with the representatives of its employees.

Business & Corporate Compliance > ... > Labor & Employment Law > Collective Bargaining & Labor Relations > Duty to Bargain

HN13[] Collective Bargaining & Labor Relations, Duty to Bargain

29 U.S.C.S. § 158(d) defines the employer's duty to bargain as part of a mutual duty between the employer and the union to meet and confer in good faith with respect to wages, hours, and other terms and conditions of employment.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN14[] Conversion & Dismissal, Reorganizations

While *11 U.S.C.S. § 1113* prescribes a process for rejection of a collective bargaining agreement, it does not mention the continuing obligations imposed by the National Labor Relations Act. However, neither does it restrict its prescription to executory or unexpired collective bargaining agreements.

Governments > Legislation > Interpretation

HN15[] Legislation, Interpretation

Statutory context can suggest the natural reading of a provision that in isolation might yield contestable interpretations.

Governments > Legislation > Interpretation

HN16 Legislation, Interpretation

In expounding a statute, the court must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN17 Conversion & Dismissal, Reorganizations

11 U.S.C.S. § 1113 balances the concerns of economically-stressed debtors in avoiding liquidation and the unions' goals of preserving labor agreements and maintaining influence in the reorganization process. Unlike *11 U.S.C.S. § 365*, which does not constrain a debtor's rejection of burdensome executory contracts, § 1113 prescribes strict procedural and substantive requirements before a collective bargaining agreement can be rejected. Specifically, before the bankruptcy court will consider an application to reject, the debtor must make a proposal, provide relevant information, meet at reasonable times, and confer in good faith. The debtor's modifications must be necessary to permit reorganization and must treat all creditors, the debtor, and all affected parties fairly and equitably. The balance of equities must clearly favor rejection of the collective bargaining agreement. The language of § 1113 was designed to foreclose all but the essential modifications of the working conditions integral to a successful reorganization. In other words, by requiring compliance with the stringent provisions of § 1113, Congress sought to ensure that, when the National Labor Relations Act yields to the Bankruptcy Code, it does so only for reasons that will permit the debtor to stay in business.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN18 Conversion & Dismissal, Reorganizations

Under 11 U.S.C.S. § 1113, approval will be granted only if the debtor's modifications are necessary to permit reorganization. In this context, when the employer's statutory obligations to maintain the status quo under the terms of an expired collective bargaining agreement will undermine the debtor's ability to reorganize and remain in business, it is the expertise of the Bankruptcy Court which is needed rather than that of the National Labor Relations Board. For that reason, whether the collective bargaining agreement is in effect or is expired, it is the Bankruptcy Court which should make the review and decide on the necessity of the modification. Therefore, § 1113 applies to a collective bargaining agreement after it has expired.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN19 Conversion & Dismissal, Reorganizations

The Bankruptcy Code, which gives debtors latitude to restructure their affairs. A Chapter 11 reorganization provides a debtor with an opportunity to reduce or extend its debts so its business can achieve long-term viability, for instance, by generating profits which will compensate creditors for some or all of any losses resulting from the bankruptcy. Congress has recognized that it is more economically efficient to reorganize rather than to liquidate, because it preserves jobs and assets. Similarly, the policy behind Chapter 11 of the Bankruptcy Code is the ultimate rehabilitation of the debtor. As the Bankruptcy Court recognized, in many cases, time is the enemy of a successful restructuring and the 11 U.S.C.S. § 1113 rejection process is a much quicker process than the relatively protracted process contemplated by the National Labor Relations Act.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN20 Conversion & Dismissal, Reorganizations

11 U.S.C.S. § 1113 furthers the Bankruptcy Code's rehabilitative policies by permitting debtors to restructure their labor obligations. A contrary holding, i.e., that § 1113 does not allow a debtor to reject expired collective bargaining agreements or its ongoing obligations, would impede that overriding goal.

Governments > Legislation > Interpretation

HN21[] Legislation, Interpretation

Courts cannot interpret federal statutes to negate their own stated purposes.

Governments > Legislation > Interpretation

HN22[] Legislation, Interpretation

Courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permit so as to carry out in particular cases the generally expressed legislative policy.

Bankruptcy Law > ... > Bankruptcy > Conversion & Dismissal > Reorganizations

Labor & Employment Law > Collective Bargaining & Labor Relations > Enforcement of Bargaining Agreements

HN23[] Conversion & Dismissal, Reorganizations

Under the policies of bankruptcy law, it is preferable to preserve jobs through a rejection of a collective bargaining agreement, as opposed to losing the positions permanently by requiring the debtor to comply with the continuing obligations set out by the collective bargaining agreement. Moreover, it is essential that the bankruptcy court be afforded the opportunity to evaluate those conditions that can detrimentally affect the life of a debtor, whether such encumbrances attach by operation of contract or a complex statutory framework.

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David M. Bass, Esquire, Michael D. Sirota, Esquire, Cole Schotz, Hackensack, NJ, Counsel for Amicus Appellees 710 Long Ridge Road Operating Company II, LLC, 240 Church Street Operating Company II, LLC, 1 Burr Road Operating Company II, LLC, 245 Orange Avenue Operating Company II, LLC and 107 Osbourne Street Operating Company II, LLC.

Judges: Before: SHWARTZ, SCIRICA and ROTH, Circuit Judges.

Opinion by: ROTH

Opinion

[*163] ROTH, Circuit Judge:

This appeal requires us to resolve the effect of two potentially conflicting provisions of federal law. ***HN1***[] *Section 1113 of the Bankruptcy Code* allows a Chapter 11 debtor to "reject" its collective bargaining agreements (CBAs) under certain circumstances.[1] The National Labor Relations Act (NLRA) prohibits an employer from

[1] 11 U.S.C. § 1113.

unilaterally changing the terms and conditions of a CBA even after its expiration.[2] **[*164]** Thus, under the NLRA, the key terms and conditions of an expired CBA continue to govern the relationship between a debtor-employer and its unionized employees until the parties reach a new agreement or bargain **[**3]** to impasse. This case presents a question of first impression among the courts of appeals: is a Chapter 11 debtor-employer able to reject the continuing terms and conditions of a CBA under § 1113 after the CBA has expired?

UNITE HERE Local 54 (Union) appeals the Bankruptcy Court's order granting the Debtors' motion to reject their CBA with the Union pursuant to § 1113(c). The Union contends that the Bankruptcy Court lacked subject matter jurisdiction to approve the Debtors' motion because the CBA had expired. The Debtors, Trump Entertainment Resorts, Inc., and its affiliated debtors,[3] contend that § 1113(c) governs all CBAs, expired and unexpired, and that the Bankruptcy Court's interpretation of § 1113 is consistent with the policies underlying the Bankruptcy Code.

We conclude that § 1113 does not distinguish between the terms of an unexpired CBA and the terms and conditions that continue to govern **[**4]** after the CBA expires. Thus, we will affirm the order of the Bankruptcy Court.

I.

A.

The facts giving rise to this appeal are undisputed. The Debtors own and operate the Trump Taj Mahal casino in Atlantic City, New Jersey. The casino employs 2,953 employees, 1,467 of whom are unionized. UNITE HERE Local 54 is the largest of the employee unions, representing 1,136 employees. The most recent CBA between the Union and Taj Mahal was negotiated in 2011 for a three-year term. It contained a duration provision — titled "term of contract" — that provided:

> The collective bargaining agreement shall remain in effect until 11:59 p.m. on September 14, 2014 and shall continue in full force and effect from year to year thereafter, unless either party serves sixty (60) days written notice of its intention to terminate, modify, or amend the Collective Bargaining Agreement.

In early 2014, due to the casino's deteriorating financial health,[4] the Debtors attempted to negotiate a new agreement. Specifically, on March 7, the Debtors gave the Union notice of their "intention to terminate, modify or amend" the CBA and asked the Union to begin negotiations for a new agreement. The Union did not respond. On April **[**5]** 10, the Debtors followed up on their request. On April 30, the Union responded that "while [it is] also anxious to commence bargaining, the Union is simply not ready, some five months out [from expiration of the CBA], to commence negotiations" but it would "contact [the Debtors] within the next several months."

[*165] On August 20, at the Debtors' request, the Union met with the Debtors to discuss terms for a new agreement. Although the Debtors emphasized their critical financial situation, the Union was not receptive to negotiations. On August 28, the Debtors proposed modifications to the CBA, including replacing the pension contributions with a 401(k) program, and replacing the health and welfare program with subsidized coverage under the Affordable Care Act. The Union responded that it was prepared to work with the Debtors on workers' pensions, but not on the health and welfare proposal. No agreement was reached.

On September **[**6]** 9, 2014, the Debtors filed for Chapter 11 bankruptcy protection. On September 11, the Debtors asked the Union to extend the term of the CBA, but the Union refused, unless the Debtors agreed to terminate the extension upon the filing of a § 1113 motion. It is undisputed that, with no new agreement in place and with the Debtors having served notice to modify the agreement, the CBA expired on September

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[2] *See* **29 U.S.C. § 158(a)(5)**; NLRB v. Katz, 369 U.S. 736, 743, 82 S. Ct. 1107, 8 L. Ed. 2d 230 (1962) (holding that HN2[↑] an employer commits an unfair labor practice if, without bargaining to impasse, it unilaterally changes existing terms or conditions of employment); Litton Fin. Printing Div. v. NLRB, 501 U.S. 190, 198, 111 S. Ct. 2215, 115 L. Ed. 2d 177 (1991) (citing Laborers Health & Welfare Trust Fund for N. Cal. v. Advanced Lightweight Concrete Co., 484 U.S. 539, 544 n.6, 108 S. Ct. 830, 98 L. Ed. 2d 936 (1988) (applying the *Katz* doctrine to expired CBAs)).

[3] The affiliated debtors include Trump Taj Mahal Associates, LLC, the Union's counter-party to the CBA.

[4] In 2011, Taj Mahal's earnings before interest, taxes, depreciation, and amortization (EBITDA) were approximately $32 million. The casino's earnings plummeted to a loss of $6.1 million in 2013. As of June 30, 2014, Taj Mahal's twelve-month EBITDA was a loss of $25.7 million.

14, 2014.

On September 17, the Debtors sent the Union a proposal with supporting documentation to demonstrate the Debtors' "dire" financial condition, and requested to meet "on any day and at any place" within the next seven days. The Union proposed to meet on September 24, for the first bargaining session. After the meeting on September 24, the Union requested additional information, which the Debtors promptly provided. Two days later, the Union sent a "counter-proposal" to the Debtors, which consisted largely of more information requests. Also on September 26, the Debtors filed a motion pursuant to 11 U.S.C. § 1113 seeking to reject the CBA and implement the terms of the Debtors' last proposal to the Union. The Debtors asserted that rejection of the CBA was necessary to their reorganization based on a three-part **[**7]** business plan, which anticipated concessions from the first lien lenders, local and state authorities, and the Union.

On October 17, 2014, following evidentiary hearings, the Bankruptcy Court granted the Debtors' motion to reject the expired CBA and authorized the Debtors to implement their last proposal.

B.

In granting the Debtors' motion, the Bankruptcy Court addressed three issues. First, the court considered whether it had the authority to grant the motion to reject the CBA, given that the CBA had expired after the bankruptcy but before the Debtors filed Debtors filed for bankruptcy but before the Debtors filed the rejection motion. The court concluded that § 1113 permits rejection of expired CBAs, reasoning that § 1113 is not limited to "unexpired" or "executory" CBAs. The court observed that, in passing § 1113 as a whole, Congress "recognized the need for an expedited process by which debtors could restructure labor obligations" and "provided several checks" to protect union employees.[5] The court could not discern a reason for distinguishing between expired and unexpired CBAs because granting the union the power to delay the bankruptcy process would subvert the "policy and bargaining power balances Congress struck in Section 1113."[6]

Having decided **[**8]** that § 1113 encompasses expired CBAs, the Bankruptcy Court determined that the Debtors satisfied the requirements of § 1113. Specifically, the court found that the Debtors' proposal **[*166]** provided "for those necessary modifications . . . that are necessary to permit the reorganization of the debtor;" that the Union rejected the proposal without good cause; and that the balance of the equities clearly favored rejection of the CBA.[7] The Bankruptcy Court noted that, based on "uncontroverted evidence" at the hearing, the Debtors would be forced to close the casino and liquidate if the requested relief were not granted.[8] The Bankruptcy Court also expressed concern that "while [the] Debtors were imploring the Union to engage with them in discussions, offering to meet '24/7,' . . . the Union was engaging in picketing, a program of misinformation . . . and, most egregiously, communicating with customers who had scheduled conferences at the Casino to urge them to take their business elsewhere."[9] It was "clear" to the Bankruptcy Court that "the Union was not focusing its efforts on negotiating to reach agreement with Debtors."[10]

Finally, the Bankruptcy Court determined that, under § 1113, it could authorize the Debtors to modify the expired CBA and implement the terms of Debtor's proposal. The court observed that the text of § 1113 did not explicitly grant the court authority to implement the proposed terms, but the "reasoned view" is that a debtor in possession is authorized "to implement changes to the terms and conditions of employment that were included in the section 1113 proposals approved by the bankruptcy court."[11]

The parties petitioned this Court for direct appeal,[12] which we granted on December 15, 2014. The Union challenges only the first issue addressed by the

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[5] *In re Trump Entm't Resorts, Inc., 519 B.R. 76, 86 (Bankr. D. Del. 2014)*.

[6] *Id. at 87*.

[7] *See id. at 88-92; see generally 11 U.S.C. § 1113(b)(1)*.

[8] *Id. at 87*.

[9] *Id. at 82*.

[10] *Id.; see id. at 81* ("The correspondence admitted into evidence is alarming **[**9]** in showing the Debtors were literally begging the Union to meet while the Union was stiff-arming the Debtors.").

[11] *Id. at 92* (citing *7 Collier on Bankruptcy* ¶ 1113.06[1][b] (16th ed. 2014)).

[12] *See* ***28 U.S.C. § 158(d)(2)***.

Bankruptcy Court, whether a Bankruptcy Court may grant a motion to reject an expired CBA under § 1113.[13]

II.

The Bankruptcy Court had jurisdiction under *28 U.S.C. §§ 157(b)* and *1334(a)*.[14] We have jurisdiction under *28 U.S.C. § 158(d)(2)(A)*. **HN3**[] We review the **[*167]** Bankruptcy Court's legal determinations *de novo*.[15]

III.

The question before us is whether § 1113 authorizes a Chapter 11 debtor to reject the continuing terms and conditions of a CBA after its expiration. Two statutory schemes **[**11]** are at issue: the NLRA and Chapter 11 of the Bankruptcy Code. We read these two statutory frameworks *seriatim*, and assume that Congress passed each subsequent law with full knowledge of the existing legal landscape.[16]

HN5[] Our role in interpreting a statute is to give effect to Congress's intent.[17] Because we presume that Congress expresses its intent through the ordinary meaning of its language, we begin our analysis by examining the plain language of the statute.[18] When statutory "language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms."[19]

Bankruptcy courts are divided on whether § 1113 permits debtors to reject expired CBAs.[20] But **HN6**[] a mere divergence in statutory construction does not render § 1113 ambiguous.[21] Instead, we must determine whether § 1113 is ambiguous by examining "the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."[22] "Specifically, **HN7**[] in interpreting the Bankruptcy Code, the Supreme Court has been reluctant to declare its provisions ambiguous, preferring **[**12]** instead to take a broader, contextual view, and urging courts to 'not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its **[*168]** object and policy.'"[23] A provision is ambiguous, "when, despite a studied examination of the statutory context, the natural reading of a provision remains elusive."[24] In that case, and as a last resort, we turn to pre-Code practice

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[13] The Union raises the issue of whether the Bankruptcy Court had the authority to "implement changes in the post-expiration terms and conditions of employment" in its Statement of Issue Presented for Review and in a single footnote in the Argument section of its brief, but does not articulate any **[**10]** arguments in support of review. Because the Union does not pursue this argument in its briefing, we assume, without deciding, that the Bankruptcy Court had the authority to implement the terms of the § 1113 proposal.

[14] Although the Union contends that the Bankruptcy Court erred in finding that it has jurisdiction under 11 U.S.C. § 1113, this case concerns the scope of a non-jurisdictional statute. *See* Arbaugh v. Y&H Corp., 546 U.S. 500, 515-16, 126 S. Ct. 1235, 163 L. Ed. 2d 1097 (2006). The Bankruptcy Court's interpretation of § 1113 did not violate the statute vesting the NLRB with exclusive jurisdiction to administer the NLRA. *See* ***29 U.S.C. § 160***. As the Bankruptcy Court recognized, **HN4**[] § 1113 allows the debtor only to terminate or modify its ongoing obligations to its employees; it does not give a bankruptcy court the authority to interpret or administer the NLRA. *See* Trump Entm't Resorts, Inc., 519 B.R. at 87 ("This is a no greater intrusion on the NLRB's jurisdiction than if the Court were to apply Section 1113 to a [CBA] which has not expired by its terms.").

[15] In re Makowka, 754 F.3d 143, 147 (3d Cir. 2014).

[16] *See* Miles v. Apex Marine Corp., 498 U.S. 19, 32, 111 S. Ct. 317, 112 L. Ed. 2d 275 (1990).

[17] *See* Idahoan Fresh v. Advantage Produce, Inc., 157 F.3d 197, 202 (3d Cir. 1998) (citing Negonsott v. Samuels, 507 U.S. 99, 104, 113 S. Ct. 1119, 122 L. Ed. 2d 457 (1993)).

[18] *See id.* (citations omitted).

[19] Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6, 120 S. Ct. 1942, 147 L. Ed. 2d 1 (2000) (internal quotation marks omitted); *see* Parker v. NutriSystem, Inc., 620 F.3d 274, 277 (3d Cir. 010).

[20] *Compare* In re 710 Long Ridge Rd. Operating Co., II, 518 B.R. 810, 830 (Bankr. D.N.J. 2014) (holding that § 1113(c) applies to CBAs that had expired prepetition), In re Karykeion, Inc., 435 B.R. 663, 675 (Bankr. C.D. Cal. 2010) (same), In re Ormet Corp., No. 2:04-CV-1151, 2005 U.S. Dist. LEXIS 42573, 2005 WL 2000704, at *2 (S.D. Ohio 2005) (same), In re Hoffman Bros. Packing Co., 173 B.R. 177, 184 (9th Cir. BAP 1994) (holding that the CBA "continues 'in effect,' as recognized by § 1113(e) and as was implicit in § 1113(c)"), Accurate Die Casting Co., 292 N.L.R.B. 982, 987-88 (1989) (dicta), *with* In re Hostess Brands, Inc., 477 B.R. 378, 382-83 (Bankr. S.D.N.Y. 2012) (holding that § 1113(c) is only

of the words and phrases that comprise § 1113,[31] or focus on a meaning that may seem plain when considered in isolation. We will turn instead to the situation in which § 1113 was enacted and examine the provision in the context of the Bankruptcy Code as a whole.[32]

B.

Section 1113 was a product of the organized labor movement's push to overturn the Supreme Court's decision in *National Labor Relations Board v. Bildisco & Bildisco*.[33] There, the Supreme Court addressed what standard governed rejection of CBAs in bankruptcy. The Court first held that CBAs were "executory contracts" under *§ 365 of the Bankruptcy Code*, and could therefore be rejected under *§ 365* if the debtor showed that they "burden[ed] the estate, and . . . the equities balance[d] in favor of rejecting the labor contract[s]."[34] In recognizing national labor policy, the Court included a bargaining component in the process of rejection, requiring an employer to make reasonable efforts to negotiate a voluntary modification of the CBA before acting on a petition to modify or reject a CBA.[35] This first holding of *Bildisco* — establishing the standard for rejecting a CBA — was unanimous.

The Court then addressed whether the debtor's noncompliance with the CBA after filing for bankruptcy but before contract rejection constituted an unfair labor practice. Justice Rehnquist, writing for the **[**18]** **[*170]** majority, found that "from the filing of a petition in bankruptcy until formal acceptance, the [CBA] is not an enforceable contract within the meaning of NLRA § 8(d)." Thus, it was not an unfair labor practice for an employer to unilaterally change the terms of a CBA after filing for bankruptcy but before the court approved rejection.[36] Justice Rehnquist reasoned that the trustee was "empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent a bankruptcy filing."[37] A rule, requiring trustees to adhere to a CBA's terms after filing, "would run directly counter to the express provisions of the Bankruptcy Code and to the Code's overall effort to give the debtor-in-possession some flexibility and

[31] The Union argues that we should attach significance to the textual contrast between § 1113(e), which allows for emergency interim relief "when the collective bargaining agreement continues in effect," and § 1113(c). The Union also contends that the word "terminate" within the context of § 1113(d)(2) suggests that there must be an unexpired CBA that can be "terminated."

[32] *In re Price, 370 F.3d at 369* (***HN15***[🡅] "Statutory context can suggest the natural reading of a provision that in isolation might yield contestable interpretations."); *see King, 135 S. Ct. at 2495*) ("But while the meaning of the phrase . . . may seem plain 'when viewed in isolation,' such a reading turns out to be 'untenable in light of [the statute] as a whole.' . . . In this instance, **[**16]** the context and structure of the [statute] compel us to depart from what would otherwise be the most natural reading of the pertinent statutory phrase." (citation omitted)); Kelly v. Robinson, 479 U.S. 36, 43, 107 S. Ct. 353, 93 L. Ed. 2d 216 (1986) (***HN16***[🡅] "In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."' (quotation marks omitted)).

[33] *465 U.S. 513, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984)*; *see* 130 Cong. **[**17]** Rec. 20,092 (1984) (statement of Sen. Kennedy) (stating that the intent of the new law is "to overturn the *Bildisco* decision which had given the trustee all but unlimited discretionary power to repudiate labor contracts and to substitute a rule of law that encourages the parties to solve their mutual problems through the collective bargaining process"); *id.* at 20,091 (statement of Sen. Packwood) (stating that "the agreement reached by the Conferees on the labor provisions in the bill brings to an end the effort to assure that labor contracts, which are negotiated in good faith, are properly protected"); *see also* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., AFL-CIO-CLC, 791 F.2d 1074, 1086 (3d Cir. 1986) ("[While we] are aware . . . that the most authoritative source of legislative intent lies in committee reports . . . [, here] there was no committee report, and we must seek guidance from the sequence of events leading to adoption of the final version of the bill, and the statements on the House and Senate floor of the legislators most involved in its drafting." (citation omitted)).

[34] Bildisco, 465 U.S. at 526.

[35] *Id.*

and legislative history to find meaning.[25]

A.

HN10[] Section 1113 of the Bankruptcy Code governs the means by which a debtor may assume, reject, or modify a CBA. It establishes an expedited negotiation process for modifying a CBA and allows for judicial evaluation of a petition to reject a CBA if negotiations are unsuccessful. Specifically, § 1113 provides that a debtor may "reject a collective bargaining agreement" if the bankruptcy court determines that (1) the debtor has "ma[de] a proposal" to its employees "which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization," (2) "the authorized representative of the employees has refused to accept such proposal without good cause," and (3) "the balance of the equities clearly favors rejection of such agreement."[26] Section 1113 explicitly forbids debtors from "terminat[ing] or alter[ing] any provisions of a collective bargaining agreement prior to compliance with the provisions" of § 1113.[27]

The Union argues that the plain meaning of a "collective bargaining agreement" is a "contract between an employer and a labor union." Therefore, because the CBA has expired, there is no "contract" to be rejected under § 1113. The Union further contends that Debtors **[**14]** are required to bargain to impasse before making any changes to the key terms and conditions of the expired CBA. The Union's position is based on **HN11**[] the NLRA's requirement that "[o]nce a collective bargaining relationship has been established, an employer may not make a change affecting [the] mandatory bargaining subjects without affording the Union the opportunity to bargain over the change."[28] Even when a CBA expires, the employer must maintain the status quo with respect to mandatory subjects of bargaining until it either enters into a new contract or bargains to impasse.[29]

HN14[] While § 1113 prescribes a process for rejection of a "collective bargaining agreement," it does not mention the continuing obligations imposed by the NLRA. However, neither does it restrict its prescription to "executory" or "unexpired" **[**15]** CBAs.[30] Following **[*169]** the lead of the Supreme Court to take a broad, contextual view of the Bankruptcy Code, we will not embark, as the parties do, on a hyper-technical parsing

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applicable to current CBAs), In re San Rafael Baking Co., 219 B.R. 860, 866 (9th Cir. BAP 1998) (same), In re Sullivan Motor Delivery, Inc., 56 B.R. 28, 29, 31 (Bankr. E.D. Wis. 1985) (same), In re Chas. P. Young Co., 111 B.R. 410, 413 (Bankr. S.D.N.Y. 1990) (noting that rejection of a CBA pursuant to § 1113(c) is a moot issue if the agreement expired by its own terms and before the bankruptcy court holds a hearing on rejection).

[21] *See* In re Price, 370 F.3d 362, 369 (3d Cir. 2004).

[22] Marshak v. Treadwell, 240 F.3d 184, 192 (3d Cir. 2001) (quoting Robinson v. Shell Oil Co., 519 U.S. 337, 341, 117 S. Ct. 843, 136 L. Ed. 2d 808 (1997)); *see* King v. Burwell, 576 U.S. __, 135 S. Ct.2480, 2489, 192 L. Ed. 2d 483 (2015) ("But **HN8**[] oftentimes the meaning—or ambiguity—of certain words or phrases may only become evident when placed in context." (quotation marks omitted)).

[23] Price, 370 F.3d at 369; *see* Official Comm. of Unsecured Creditors of Cybergenics Corp., ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548, 559 (3d Cir. 2003) (**HN9**[] "Statutory construction is a holistic endeavor, and this is especially true of the Bankruptcy Code." (quotation marks, **[**13]** alterations and citations omitted)).

[24] Price, 370 F.3d at 369.

[25] *See id.*

[26] 11 U.S.C. § 1113(a), (b)(1), (c).

[27] *Id.* § 1113(f).

[28] Champion Parts Rebuilders, Inc. v. NLRB, 717 F.2d 845, 852 (3d Cir. 1983) (citing Katz, 369 U.S. at 743)); *see* **HN12**[] ***29 U.S.C. § 158(a)(5)*** (providing that it "shall be an unfair labor practice for an employer" to "refuse to bargain collectively with the representatives of [its] employees"); *id.* **HN13**[] ***§ 158(d)*** (defining the employer's duty to bargain as part of a mutual duty between the employer and the union to "meet . . . and confer in good faith with respect to wages, hours, and other terms and conditions of employment").

[29] *See* Litton, 501 U.S. at 199; Citizens Publ'g & Printing Co. v. NLRB, 263 F.3d 224, 233 (3d Cir. 2001).

[30] *Cf.* ***11 U.S.C. § 365***. ***Section 365*** permits unilateral rejection of any executory contracts or unexpired leases burdensome to the estate. *See* Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp., 872 F.2d 36, 39 (3d Cir. 1989).

reasons that will permit the debtor to stay in business.[44]

This case exemplifies the process that Congress intended. Rejection of the Debtors' continuing labor obligations, as defined by the expired CBA, is necessary to permit the Debtors' reorganization — indeed it is essential to the Debtors' survival. As the Bankruptcy Court repeatedly emphasized, the Debtors' "financial situation is desperate. Not only are their losses large, but they have been unable to obtain debtor in possession financing for their **[**23]** bankruptcy cases and are operating with cash collateral. Debtors' cash will run out in less than two months."[45] The Debtors' expert, whom the Bankruptcy Court found "highly credible," testified that the

> Debtors must have relief from the CBA without which they can not avoid closing the Casino and liquidating their businesses. . . . [T]he situation is so grim that without the Court granting the Motion and Debtors obtaining other concessions, Debtors would have to give notice to the New Jersey Department of Gaming Enforcement not later than October 20, 2014, that Taj Mahal will close the Casino.[46]

The Debtors sold assets and closed one of their casinos, the Trump Plaza Hotel and Casino, to raise cash and reduce their obligations. As of September 5, 2014, the Debtors' working capital cash was approximately $12 million, and its secured debt was approximately $286 million. Under **[*172]** the relevant terms of the CBA, however, the Debtors were required to make more than $3.5 million per year in pension contributions, and $10 to $12 million per year in health and welfare contributions. After the CBA expired, the Debtors were required to sustain those payments at the same levels. To avoid liquidation, the **[**24]** Debtors moved to reject the CBA. Their § 1113 proposal to the Union included annual savings of approximately $3.7 million per year in pension contributions, $5.1 million in health and welfare contributions, and $5.8 million in work rule changes, including elimination of paid meal times. Instead of negotiating with the Debtors, the Union stalled the bargaining sessions, engaged in picketing, and attempted to harm the Debtors' business.[47]

Notably, the Debtors' plan of reorganization is contingent on rejection of the CBA, the obtaining of tax relief, the conversion of the first lien secured creditor's debt to equity, and a capital infusion of $100 million from the first lien secured creditor. The first lien secured creditor "has made it clear that it will perform only if the CBA and tax relief contingencies are achieved because the business will not succeed without the relief."[48] A successful reorganization, therefore, depends on the rejection of the terms that the Debtors are required to maintain under the NLRA.

The Union recognizes that the Debtors are bound by the terms and conditions of the expired CBA by virtue of their obligation to maintain the status quo. Nevertheless, the Union argues that those **[**25]** obligations are "entirely distinct from the parties' voluntarily assumed contractual obligation to honor their CBA prior to its expiration." The Union relies on *Laborers Health & Welfare Trust Fund for Northern California v. Advanced Lightweight Concrete Company*.[49] This case involved the withdrawal of an employer from a multiemployer pension fund and the employer's subsequent failure to make payments to the fund as required by the expired CBA. The trustee of the fund brought suit in federal court to enforce the terms of the expired CBA. The Supreme Court distinguished an employer's obligation to make contributions to such a pension fund pursuant to the terms of a CBA from an employer's continuing obligation under the NLRA to make post-expiration contributions. The Court held that, because an

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of attempted rejections of [CBAs] by debtor employers."); 130 Cong. Rec. 20,092 (1984) **[**21]** (statement of Sen. Packwood) (noting that "the debtor will not be able to exploit the bankruptcy procedure to rid itself of unwanted features of the labor agreement that have no relation to its financial condition and its reorganization and which earlier were agreed to by the debtor").

[43] *See* Wheeling-Pittsburgh Steel Corp., 791 F.2d at 1088.

[44] *See* 130 Cong. Rec. 20,231 (1984) (statement of Rep. Morrison) ("[T]he conference report strikes the necessary balance between the threat to companies in risk of being liquidated because of financial problems and the possibility of abuse of chapter 11 bankruptcy proceedings merely to vitiate union contracts"); *id.* at 20,232 (statement of Rep. Morrison) ("[A] chapter 11 reorganization case that is brought for the sole purpose or [sic] repudiating or modifying a [CBA] is a case brought in 'bad faith.'").

[45] *Trump Entm't Resorts, Inc., 519 B.R. at 80*.

[46] *Id.*

[47] *Id. at 81-82*.

[48] *Id. at 83*.

[49] *484 U.S. 539, 108 S. Ct. 830, 98 L. Ed. 2d 936 (1988)*.

breathing space."[38] He noted:

> The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources. . . . [A] beneficial recapitalization could be jeopardized if the debtor-in-possession were saddled automatically with the debtor's prior collective-bargaining agreement. Thus, the authority to reject an executory contract is vital to the basic purpose **[**19]** to a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization.[39]

In response to *Bildisco*, Congress swiftly[40] passed *§ 1113* to overturn the second part of *Bildisco's* holding and prohibit unilateral changes in debtors' CBAs without bankruptcy court approval.[41] In crafting the stringent requirements of *§ 1113*, Congress was focused on preventing employers from terminating negotiated labor contracts and avoiding burdensome obligations to employees merely by entering bankruptcy.[42]

[*171] As enacted, ***HN17*** [🡅] *§ 1113* balances the concerns of economically-stressed debtors in avoiding liquidation and the unions' goals of preserving labor agreements and maintaining influence in the reorganization process. Unlike *§ 365*, which does not constrain a debtor's rejection of burdensome executory contracts, *§ 1113* prescribes strict procedural and substantive requirements before a CBA can be rejected. Specifically, before the bankruptcy court will consider an application to reject, the debtor must make a proposal, provide relevant information, meet at reasonable times, and confer in good faith. The debtor's modifications must be "necessary" to permit reorganization and must treat all creditors, the debtor, and all affected parties "fairly and equitably." The balance of equities must "clearly favor" rejection of the CBA. The language of *§ 1113* was designed to foreclose all but the essential modifications of the working conditions integral **[**22]** to a successful reorganization.[43] In other words, by requiring compliance with the stringent provisions of *§ 1113*, Congress sought to ensure that, when the NLRA yields to the Bankruptcy Code, it does so only for

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[36] *Id. 529-33* ("Since the filing of a petition in bankruptcy under Chapter 11 makes the contract unenforceable, § 8(d) procedures have no application to the employer's unilateral rejection of an already unenforceable contract. . . . Our rejection of the need for full compliance with § 8(d) procedures of necessity means that any corresponding duty to bargain to impasse under § 8(a)(5) and § 8(d) before seeking rejection must also be subordinated to the exigencies of bankruptcy.").

[37] *Id. at 528*.

[38] *Id. at 532*.

[39] *Id. at 528*.

[40] *See* Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement — A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 Am. Bankr. L.J. 293, 313 (1984) ("On the same day *Bildisco* was decided, Congressman **[**20]** Rodino introduced H.R. 4908 to clarify the circumstances under which collective bargaining agreements may be rejected." (footnotes and quotation marks omitted)); 130 Cong. Rec. 6191 (statement of Rep. Hyde) (describing the House as taking action with "mind boggling speed"); 130 Cong. Rec. 13,205 (statement of Sen. Denton) (stating that "[i]t is notable that the *Bildisco* provision was introduced only 2 days before it was taken up on the floor, was never considered by the House Judiciary Committee in hearings or committee markups, and was brought to the House floor under a rule that did not permit the House to vote on it separately from the bankruptcy bill.").

[41] *See 11 U.S.C. § 1113(f)*.

[42] *In re Roth Am., Inc., 975 F.2d 949, 956 (3d Cir. 1992)*; *see In re Maxwell Newspapers, Inc., 981 F.2d 85, 89 (2d Cir. 1992)* ("*[Section] 1113* also imposes requirements on the debtor to prevent it from using bankruptcy as a judicial hammer to break the union."); *In re Century Brass Prods., Inc., 795 F.2d 265, 272 (2d Cir. 1986)* ("*[Section 1113]* created an expedited form of collective bargaining with several safeguards designed to insure that employers did not use Chapter 11 as medicine to rid themselves of corporate indigestion."); *Sullivan Motor Delivery, Inc., 56 B.R. at 30* ("The elaborate procedure established under *§ 1113* is a conscious effort by Congress to slow down the potential for an avalanche

profits which will compensate creditors for some or all of any losses resulting from the bankruptcy. Congress has recognized that "[i]t is more economically efficient to reorganize rather than to liquidate, because it preserves jobs and assets."[56] Similarly, we have held that "[t]he policy behind Chapter 11 of the Bankruptcy Code is the 'ultimate rehabilitation of the debtor.'"[57] As the Bankruptcy Court recognized, "[i]n many cases, time is the enemy of a successful restructuring" and the § 1113 rejection process is a "much quicker process than the relatively protracted process contemplated by the NLRA."[58]

HN20[🡅] Section 1113 furthers the Code's rehabilitative policies by permitting debtors to restructure their labor obligations. A contrary holding, *i.e.*, that § 1113 does not allow a debtor to reject expired CBAs or its ongoing obligations, would impede that overriding goal.[59] Whether by force of contract or by operation of the NLRA, the Debtors here were bound by the key terms of the expired CBA. But those terms burdened the estate so as to preclude a successful reorganization. Just because the Debtors filed the § 1113 motion one week after the CBA expired, they should not be bound by the expired agreement's burdensome terms until the parties negotiate to impasse. That interpretation of the statute would undercut the rehabilitative function of Chapter 11.[60]

HN23[🡅] Under the policies of bankruptcy law, it is preferable to preserve jobs through a rejection of a CBA, as opposed to losing the positions permanently by requiring the debtor to comply with the continuing obligations set out by the CBA. Moreover, it is essential that the Bankruptcy Court be afforded the opportunity to evaluate those conditions that can detrimentally affect the life of a debtor, whether **[**32]** such encumbrances attach by operation of contract or **[*175]** a complex statutory framework. In light of Chapter 11's overarching purposes and the exigencies that the Debtors faced, we conclude that the Bankruptcy Court did not err in granting the Debtors' motion.

IV.

For the reasons set forth above, we will affirm the judgment of the Bankruptcy Court.

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[56] H.R. Rep. No. 95-595, at 220 (1977) (stating that the premise of business reorganization is that a company's assets are worth more as a going concern than if sold for scrap); *see* 130 Cong. Rec. 20,230 (1984) (statement of Rep. Lungren, discussing § 1113) ("This is an important provision in the compromise **[**30]** because it underscores the primary purpose of chapter 11; that is, to maintain the debtor's business so that both the debtor and his employees can keep their jobs. . . . [T]his chapter 11 allows a company to reorganize rather than going belly-up. In essence, it is the best way to protect the jobs of the workers of the company as then constituted.").

[57] In re Exide Techs., 607 F.3d 957, 962 (3d Cir. 2010) (quoting Nicholas v. United States, 384 U.S. 678, 687, 86 S. Ct. 1674, 16 L. Ed. 2d 853 (1966).

[58] Trump Entm't Resorts, 519 B.R. at 86.

[59] *See* 130 Cong. Rec. 20,230 (1984) (statement of Rep. Lungren) (noting that "[a]ny labor provision which would subordinate **[**31]** the debtor's reorganization to a union contract . . . would impinge on the goals of the 1978 Bankruptcy Reform Act and indeed on the principal reasons for a bankruptcy procedure"); *id.* at 20,231 (statement of Rep. Hall) (asking whether "the court in balancing equities would include the union contract — *and any other matters that might make it detrimental to the debtor* for the contract to remain in force" (emphasis added)).

[60] *See* King, 135 S. Ct. 2492-93 (citing N.Y. State Dep't of Soc. Servs. v. Dublino, 413 U.S. 405, 419-20, 93 S. Ct. 2507, 37 L. Ed. 2d 688 (1973) (**HN21**[🡅] "We cannot interpret federal statutes to negate their own stated purposes.")); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350-51, 64 S. Ct. 120, 88 L. Ed. 88 (1943) (**HN22**[🡅] "[C]ourts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permit so as to carry out in particular cases the generally expressed legislative policy.").

employer's contractual duty to make multiemployer pension fund contributions does not survive the CBA's expiration, the employer's failure to make post-expiration contributions does not constitute a violation of *§ 515 of ERISA*.[50] The Court concluded that § 515 was intended to cover only obligations arising under the CBA. To seek contributions from an employer after the expiration of the CBA, the trustee would have to **[**26]** go before the NLRB to obtain a remedy in a proceeding before that body; the district court did not have jurisdiction to hear the claim.

The Court in *Laborers Health* found Congress's intent in enacting § 515 was clear.[51] The Court added that there were **[*173]** three countervailing policy arguments to support its decision that the reach of § 515 was deliberate rather than inadvertent. First, if there is a gap in the enforcement scheme to enforce contributions to multiemployer funds, its incidence is unknown and, since it has not been called to the attention of Congress, "it may not be a problem of serious magnitude."[52] Second, the issues to be decided in a dispute over an employer's failure to make fund contributions are more complex when the refusal is post-CBA rather than a simple collection action during the life of the CBA.[53] Third, a violation of the duty to bargain in good faith is a labor law matter and is better decided by the NLRB than by a district court. **[**27]** [54]

Conversely, we find the intent of Congress here also to be clear but that intent was to incorporate expired CBAs in the language of *§ 1113*. Our review of the decision in *Laborers Health* demonstrates to us that the three countervailing policy arguments in *Laborers Health* support our decision here. As we noted above, *§ 1113* was enacted to balance the needs of economically-stressed debtors in avoiding liquidation and the unions' needs in preserving labor agreements and safeguarding employment for their members. *Section 1113* meets a gap in the schemes to permit reorganizations when labor obligations will prevent the success of a reorganization. The number of cases cited in footnote 20 *supra* demonstrate this gap. *Section 1113* was enacted to ensure that relief from a CBA was granted only in situations where relief was necessary to permit the reorganization. It is a counter to the precedent in *Bildisco* which permitted modification of a CBA without close scrutiny by the Bankruptcy Court. ***HN18***[] Under *§ 1113*, approval will be granted only if the debtor's modifications are necessary to permit reorganization. In this context, when the employer's statutory obligations to maintain the status quo under the terms of an expired CBA will undermine **[**28]** the debtor's ability to reorganize and remain in business, it is the expertise of the Bankruptcy Court which is needed rather than that of the NLRB. For that reason, whether the CBA is in effect or is expired, it is the Bankruptcy Court which should make the review and decide on the necessity of the modification. We conclude, therefore, that *§ 1113* applies to a CBA after it has expired.

The Union contends, however, that because a debtor may not assume or reject an expired executory contract under *§ 365*, it may not reject an expired CBA under *§ 1113*. This argument ignores an important distinction between a CBA and any other executory contract: the key terms and conditions of a CBA continue to burden the debtor after the agreement's expiration. Rejection of those terms, therefore, is not a moot issue as would be in the case of other contracts or leases.

C.

To hold that a debtor may reject an expired CBA or its continuing obligations as defined by the expired CBA is also consistent with the purpose of***HN19***[] the Bankruptcy Code, which gives debtors latitude to restructure their affairs.[55] A **[*174]** Chapter 11 reorganization provides a debtor with an opportunity to reduce or extend its debts so its business can achieve long-term **[**29]** viability, for instance, by generating

[50] Section 515 was enacted to protect multiemployer funds and the other employers participating in them from the withdrawal of an employer from the fund. It obligates employers, even after withdrawal, to make contributions under the terms of a plan or of a CBA. *29 U.S.C. § 1145*.

[51] *Laborers Health, 484 U.S. at 551*.

[52] *Id.*.

[53] *Id. at 551-52*.

[54] *Id. at 552*.

[55] *See Perez v. Campbell, 402 U.S. 637, 648, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971)* ("This Court on numerous occasions has stated that '(o)ne of the primary purposes of the Bankruptcy Act' is to give debtors 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.'" (quoting *Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S. Ct. 695, 78 L. Ed. 1230 (1934)*)).