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Date of Hearing: July 26, 2012 @ 2:00 pm

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
Hawker Beechcraft, Inc., *et al.*,	Case No. 12-11873 (SMB)
Debtors.	(Jointly Administered)

OBJECTION OF INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS, AFL-CIO TO DEBTORS' MOTION FOR THE ENTRY OF AN ORDER APPROVING THE DEBTORS' KEY EMPLOYEE INCENTIVE PLAN AND KEY EMPLOYEE RETENTION PLAN AND GRANTING RELATED RELIEF

The International Associations of Machinists and Aerospace Workers, AFL-CIO (the "**IAM**") submits this objection to the Debtors' *Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan and Key Employee*

Retention Plan and Granting Related Relief [Docket No. 349] (the "**Motion**")[1] and in support thereof states as follows:

Preliminary Statement

1. The IAM represents approximately 2000 of the Debtors' employees, or approximately 45% of the Debtors' current active workforce.

2. The IAM objects to the Motion pursuant to which the Debtors propose to implement both a (a) key employee incentive plan (the "**KEIP**") that would unnecessarily and excessively compensate eight senior level executives and (b) key employee retention plan (the "**KERP**"). As explained below, regardless of what standard is applied, the KEIP and KERP should not be approved. This is especially true for the KEIP, which essentially seeks to pay eight senior executives up to an astonishing 200% of their base salary for achieving routine, short term and not particularly challenging or value enhancing performance targets. The attempt to implement such a lucrative bonus program for the very executives who led the Debtors' into bankruptcy is particularly egregious in light of the fact that (a) thousands of rank-and-file employees have lost their jobs, (b) it is likely that hundreds or thousands of additional workers will lose their jobs under either the Debtors' Standalone Transaction or a Third-Party Transaction and (c) the Debtors are attempting to reduce over-all compensation for rank-and-file employees by seeking to terminate their pension plans.

3. The Motion, as it relates to the KEIP, should be denied because the KEIP is a disguised retention plan for "insiders" that does not satisfy the requirements of Bankruptcy Code section 503(c)(1). In essence, the Debtors seek authority to grant up to $5.3 million in "pay to stay" bonuses to eight (8) "insiders" for staying through either the

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[1] Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to such items in the Motion.

consummation of the Debtors' prenegotiated Standalone Transaction or a Third-Party Transaction, which the Debtors are currently in the process of negotiating with Superior Aviation Beijing ("**Superior**"). The eight executives who are eligible for the KEIP would reap the benefit of the extravagant bonuses by remaining with the Debtors and allowing the work that the Debtors have already done to play itself out as a matter of course. The KEIP fails to provide meaningful and challenging goals that would trigger the bonus awards because the Standalone Transaction (which was negotiated prepetition) and Third-Party Transaction are already well on track toward consummation. These executives, who already have a fiduciary duty to the estate to maximize value, should not need any additional incentive to complete either the Standalone Transaction or the Third-Party Transaction. This is particularly true since the Standalone Plan and the proposed Third-Party Transaction with Superior contemplates that existing management will remain in place after the closing of either transaction.[2]

4. The KEIP does not contain any true results-oriented "incentive thresholds" such as meaningful performance targets, benchmarks or other material value-added metrics or guidelines. "Incentive", as the term is defined in the dictionary, is "something that incites or tends to incite to action or greater effort, as a reward offered for increased productivity." www.Dictionary.com., which is available at http://dictionary.reference.com/browse/incentive. The KEIP does not contain any material productivity enhancing targets. As noted above, the most significant aspects of these transactions have already occurred and the eight executives should not need any added incentives to complete these short term tasks of either consummating the Standalone Transaction or Third-Party Transaction. Rather, the lack of true incentives

[2] *See* Disclosure Statement For Debtors' Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code (the "**Debtors' DS**") [Docket No. 305] at 39 (stating "The existing officers of the Debtors as of the Petition Date shall remain in their current capacities as officers of the Reorganized Debtors"). *See also* Superior Proposal at 3 (stating "Superior intends to retain key executive personnel").

going forward serve to expose the KEIP for what it really is – a retention plan that does not satisfy either section 503(c)(1) or 503(c)(3) of the Bankruptcy Code.

5. Furthermore, assuming *arguendo* that the KEIP is properly characterized as an incentive plan, the Motion should be denied because it is not justified by the facts and circumstances of this chapter 11 case as required by section 503(c)(3) of the Bankruptcy Code.

6. The timing of this Motion alone, demonstrates that the KEIP is not justified by the facts and circumstances and is not an exercise of sound business judgment. As noted above, the vast majority of the work regarding the Standalone Transaction and a Third-Party Transaction has already taken place and consummation of either of those transactions is highly likely to occur. Thus, the proposed incentive metrics are not particularly challenging. The timing, together with the lack of truly incentivizing performance metrics serve to highlight that the Motion is not intended to reward the KEIP Executives for achieving meaningful results. Rather, the KEIP is meant to increase the compensation of the Debtors' senior executives for remaining with the Debtors as they complete their restructuring process.

7. Moreover, the proposed payouts under the KEIP are extraordinarily excessive. If the purported "stretch goals" are met, the KEIP Executives stand to receive up to 200% of their annual base compensation. A 200% bonus is clearly outside of the realms of reasonable compensation and is not "justified by the facts and circumstances of the case." The fact that these executives failed to receive bonuses in 2011 when they were leading Hawker toward chapter 11 does not provide a basis for them to receive excessive compensation in 2012. Rather, as conceded by the Debtors, the KEIP Executives failed to receive any bonuses under the pre-petition incentive plan since "the applicable performance metrics were not achieved in fiscal year 2011." *See* Motion

at ¶¶ 11, 34. *See also* Declaration of Robert S. Miller in Support of the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Program and the Key Employee Retention Program (the "**Miller Decl**.") at ¶ 11; Declaration of Nick Bubnovich in Support of the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan and Key Employee Retention Plan and Granting Related Relief (the "**Bubnovich Decl**.") at ¶ 13.

8. Finally, the Court should consider that thousands of jobs have already been lost under this management team and that hundreds, if not thousands, of additional jobs in the United States may be lost either entirely or through outsourcing to China in the event of a Third-Party Transaction with Superior. Furthermore, at the same time that the Debtors' are seeking to pay eight senior executives up to 200% of their base salary for work to be performed in the next several months, the Debtors are proposing to terminate their pension plans for hourly workers. The irony of seeking to pay extraordinary bonuses to certain high level executives for meeting relatively routine targets while at the same time reducing the benefits of the majority of the Debtors' ordinary workforce should not be disregarded.

Relevant Background

9. On May 3, 2012 (the "**Petition Date**"), each of the Debtors filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "**Bankruptcy Code**") in the United States Bankruptcy Court for the Southern District of New York.

10. The Debtors continue to manage and operate their businesses and properties as debtors-in-possession pursuant to section 1107 and 1108 of the bankruptcy Code.

11. On May 4, 2012, the Court entered an order directing that the Debtors' chapter 11 cases be jointly administered for procedural purposes only pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the "**Bankruptcy Rules**"). [Docket No. 34]

12. The Debtors manufacture business jets, trainer/attack aircraft as well as propeller and piston aircraft under the Hawker and Beechcraft brands. As of the Petition Date, the Debtors employed approximately 5,420 employees, of which 2,430 were members of the IAM. *See* Declaration of Robert S. Miller (I) In Support of the Debtors' Chapter 11 Petitions and First Day Declarations and (II) Pursuant to Local Bankruptcy Rule 1007-2 [Docket No. 22] (the "**First Day Decl.**") ¶ 6.

13. The Debtors filed their chapter 11 petition with a comprehensive and extensive restructuring plan already in place that was agreed to by a majority of the Debtors' prepetition secured creditors and prepetition senior bondholders. *See* Motion at ¶ 6 and First Day Decl. at ¶ 2. After extensive negotiations, the Debtors, together with 68.14% of their prepetition secured lenders and 72.55% of their prepetition senior bondholders (collectively, the "**Consenting Creditors**") entered into a Restructuring Support Agreement (the "**RSA**"). *Id*. Pursuant to the RSA, the Debtors' would convert 100% of their prepetition secured bank debt and their prepetition unsecured bond debt into equity. *Id*. The Consenting Creditors would be required to support the Debtors restructuring process in which their debt would be converted into equity of the reorganized company. *Id*. at ¶ 60. The RSA also sets forth a mandatory timeline for which the Debtors are required to complete their restructuring process. *Id*.

14. On June 30, 2012, less than two months after the Petition Date, the Debtors filed their plan of reorganization (the "**Plan**") and disclosure statement (the "**DS**"). *See* Docket No. 304 and 305. The Plan and DS essentially incorporate the restructuring that is outlined in the RSA.

15. Only ten days later, on July 10, 2012, the Debtors filed a motion to enter into an exclusive negotiation agreement with Superior. *See* Debtors' Motion for the Entry of an Order Authorizing the Debtors to Enter Into an Exclusive Negotiations Agreement and a Refund Agreement [Docket No. 324] (the "**Superior Motion**"). On July 17, 2012, the Court granted the Debtors' request. *See* Docket No. 361. Pursuant to the Superior Motion, the Debtors have agreed to negotiate exclusively with Superior for a period of 45 days to become the stalking horse bidder to acquire certain of the Debtors' assets for a purchase price of $1.79 billion. *See* Superior Motion, ¶ 4.

16. Although there is little information provided regarding Superior, it is an entity primarily backed and financed by the Chinese government. As part of the Superior Proposal, Superior would not assume any obligations relating to the Debtors' three defined benefit pension plans, including the pension plan covering IAM employees, nor would it assume any obligations for post-employment benefits (other than COBRA benefits which are paid for by employees). *See* Superior Proposal, ¶ 1.

17. Moreover, although the Debtors' have asserted that the Superior Proposal "could preserve thousands of American jobs," s*ee* Superior Motion, ¶ 15, there is nothing in the record to support such a belief. In fact, since last year the Debtors have laid off approximately 600 IAM-represented employees and have issued WARN notices to additional employees, and the Superior Proposal does not contain any commitment to preserve any jobs for any period of time. There is no reason to believe that Superior, an entity owned and financed by the Chinese government and the Beijing municipal

development corporations, would preserve jobs in the United States rather than eventually transporting the work to China.

The Debtors' Motion

The KEIP

18. On July 13, 2012, the Debtors filed the Motion seeking permission to implement the KEIP and KERP. The Debtors allege generally that the KEIP and KERP are critical to enable them to successfully complete the restructuring process in these chapter 11 cases and to motivate the management members and align their interest with those of the Debtors' stakeholders. *See* Motion ¶¶ 15, 16, 24, 29, 45, 47.

19. The KEIP would apply to eight (8) senior level executives (the "**KEIP Executives**") whom the Debtors concede are "insiders" under section 101(31) of the Bankruptcy Code. *Id.* at ¶ 18. The KEIP Executives include: the 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 and Global Customer Support, the Chief Financial Officer,[3] and the Executive Vice President of Customers. *Id.* at ¶ 18. The total annual salaries of the KEIP Executives are $2,664,000. *Id.* at ¶ 25. Under the KEIP, the Debtors are seeking authority to pay aggregate bonuses of up to $5,328,000, or an astonishing 200% of base salary. *Id*. The Debtors allege, without providing specific evidence, that the KEIP Executives are critical to a successful restructuring process and to obtain maximum value for the Debtors' estate. *Id.* at ¶ 19.

[3] It should be noted that the CFO was only hired in September 2011, and has only been working for the Debtors for a mere 10 months. *See* First Day Decl. at ¶ 56.

20. Under the KEIP, the Debtors are proposing two potential (but exclusive) methods for providing compensation bonuses to the KEIP Executives: either (i) consummation of the Standalone Transaction, which is the consensual restructuring plan that was agreed to by a majority of the prepetition lenders and bondholders prior to the Petition Date, or (ii) approval and consummation of a Third-Party Transaction. *Id.* at ¶ 16.

21. Under the Standalone Transaction, the KEIP Executives would receive the Standalone Transaction Award, which would include a Consummation Award and a Financial Performance Award. The Consummation Award is based on a percentage of the KEIP Executive's base salary. The Consummation Bonus has a maximum value of 100% of base salary. *Id* at ¶ 25. The range of dates for the Consummation Award (the "**Consummation Dates**") are as follows: before November 17, 2012, 100% of base salary, while after December, 15, 2012 would be zero. *Id*. at ¶ 21. The target Consummation Date is between December 8, 2012 and December 15, 2012, in which case the KEIP Executives would receive 50% of their base salary as a bonus[4]. *Id.*

22. The Financial Performance Award would be triggered upon achieving certain levels of Cumulative Net Cash Flow. *Id*. at ¶ 23. Similar to the Consummation Award, the Financial Performance Award would equal a percentage of the executives' base salary up to 100% of base salary. *Id*. Based upon the Consummation Date, the Debtors have proposed various ranges for their Cumulative Net Cash Flow

[4] It should be noted, that these dates could be extended at the discretion of the Consenting Creditors and the Committee. *See* Motion at ¶ 21. The dates will also be extended by the number of days beyond August 31, 2012, in which the Debtors have not resolved the treatment of their three IRS-qualified defined pension plans. *Id*.

which would provide the KEIP Executives with a bonus ranging between 50% and 100% of their annual base salary. *Id*.

23. Payment of the Consummation Award and the Financial Performance Award would be made on the effective date of a confirmed plan, provided that the KEIP Executive is still employed by the Debtors. *Id*. at ¶ 27.

24. In the event of a Third-Party Transaction, the KEIP Executives would receive bonuses equal to 200% of their base salary (the "**Third-Party Transaction Award**"), provided the transaction closes prior to January 15, 2013 and results in a purchase price of at least $1.79 billion. *Id*. at 29. Payment of the Third-Party Bonus would be distributed on the effective date of the transaction. *Id*. at 30.

The KERP

25. The Debtors also seek approval of a KERP, pursuant to which approximately 31 of the Debtors' management-level employees (the "**KERP Participants**") would be entitled to receive aggregate cash bonus up to $1,900,000 (the "**KERP Payout**"). *Id*. at ¶ 38. The KERP Participants would be entitled to receive the cash bonus upon either (i) the effective date of a plan of reorganization, or (ii) consummation of a Third-Party Transaction. *Id*. at ¶ 37. The KERP Participants would be divided into six categories and each category would be entitled to a fixed percentage of the KERP Payout. *Id*. at ¶ 38. Although the actual amount of each KERP Participant's bonus will be discretionary, no KERP Participant will receive a bonus that is greater than 50% of the employee's base salary. *Id*. The Motion does not provide any specific names, titles or salaries of the 31 individual KERP Participants. The Motion simply states that

they work at the following levels: "manager, senior manager, general manager, vice president, senior vice president and director. *Id*. at ¶ 35.

<u>The Objection</u>

26. Fundamentally, and contrary to the Debtors' assertions, the KEIP is not an incentive program designed to reward the Debtors' senior executives for achieving material value-enhancing targets either during or after the Chapter 11 Case. Rather, by the Motion, the Debtors propose to make lump sum awards totaling up to $5.3 million (or up to 200% of the base salary) to eight insiders to remain with the Debtors while they complete the restructuring process that is already in place and close to consummation. In short, the Motion seeks to approve a postpetition retention program whose primary purpose is to encourage certain insiders to remain with the Debtors for a short period of time and to pay them millions of dollars for doing so.

27. The IAM submits that the proposed KEIP is a disguised retention plan that fails to satisfy the strict criteria found in section 503(c)(1) of the Bankruptcy Code that apply to postpetition retention programs for insiders. Alternatively, the implementation of the KEIP is not a sound exercise of the Debtors' business judgment under section 363(b), nor is it justified by the facts and circumstances of the chapter 11 case as required by section 503(c)(3) of the Bankruptcy Code because it is seeking to provide bonuses that are unnecessary and excessive. Accordingly, the Court should deny the Debtors' Motion to the extent it seeks approval of the KEIP.

A. The KEIP is a Disguised Retention Plan that Violates Section 503(c)(1) of the Bankruptcy Code

28. Like many provisions under the Bankruptcy Code of 1978, the Bankruptcy Code sections associated with key employee programs were revised under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("**BAPCPA**"). Prior to the BAPCPA bankruptcy courts generally employed the "business judgment" rule on a case-by-case basis when considering approval of postpetition employee retention and bonus plans. *See In re Brooklyn Hospital Center*, 341 B.R. 405, 413 (Bankr. E.D.N.Y. 2006).

29. However, through BAPCPA, Congress added section 503(c) to govern the review and appropriateness of retention and other forms of postpetition compensation to insiders. Bankruptcy Code section 503(c) states:

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

11 U.S.C. § 503(c).

30. Section 503(c)(1) severely limits any payments to insiders "for the purpose of inducing such person to remain with the debtor's business...." 11 U.S.C. § 503(c)(1); *see In re Velo Holdings,* 2012 WL 2015870 at *5 (Bankr. S.D.N.Y. June 6, 2012) (stating "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.*, 2010 WL 3810899 at *1 (Bankr. S.D.N.Y. 2010); *In re Nellson Nutraceutical*, Inc., 369 B.R. 787, 800 (Bankr. D. Del. 2007); *In re Global Home Products LLC*, 369 B.R. 778, 783-84 (Bankr. D. Del. 2007); *In re Dana Corp.*, 358 B.R. 567 (Bankr. S.D.N.Y. 2006) (*Dana II*); *In re Dana Corp.*, 351 B.R. 96, 100 (Bankr. S.D.N.Y. 2006) (*Dana I*); *In re U.S. Airways, Inc.*, 329 B.R. 793, 797-98 (Bankr. E.D. Va. 2005) (stating that "changes will severely limit both the circumstances under which severance and retention payments may be made to insiders as well as the amount of such payments….").

31. The purpose of section 503(c)(1) is "to limit a debtor's ability to favor powerful insiders economically at estate expense during a chapter 11 case." *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 234 (Bankr. N.D. Tex. 2009). In enacting the provision, Congress sought "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. at 784 (internal quotation omitted). To achieve that goal, Congress established specific and rigorous evidentiary standards that must be satisfied by a proponent before a bankruptcy court may authorize payments to an insider for the purpose of inducing the insider to remain with the debtor's business. *See Dana I*, 351 B.R. at 100.

32. In an effort to avoid the rigorous criteria embodied in section 503(c)(1), the Debtors have chosen to characterize their KEIP as a performance based incentive program and attempt to justify the enormous awards as an exercise of reasonable business judgment. Courts, however, do not determine whether section 503(c)(1) applies to a postpetition compensation plan based upon the label the debtor places on the plan. Rather, when determining whether a compensation program is subject to section 503(c)(1) of the Bankruptcy Code, courts consider the circumstances under which particular proposals are made, along with the structure of the compensation package. *See In re Mesa Air Group*, 2010 WL 3810899 at *2; s*ee Dana I*, 351 B.R. at 102 n. 3 (stating that if a proposed KEIP "walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP)."). Any attempt by a debtor to mischaracterize a retention plan in order to bypass the requirements of section 503(c)(1) should be looked

upon with disfavor. *See e.g. In re Velo Holdings,* 2012 WL 2015870 at *6 (Bankr. S.D.N.Y. 2012); *In re Borders Group, Inc*., 453 B.R. 459, 470 (Bankr. S.D.N.Y. 2011).

33. The Debtors argue that the KEIP is incentive driven because it is designed to incentivize KEIP participants and to "motivate the members of the Debtors' management and align their incentives with those of the Debtors' stakeholders." *See* Motion ¶ 16. However, an analysis of the terms of the plan and the circumstances under which it was proposed demonstrate that the KEIP is a retention plan because its primary purpose is to encourage the KEIP Participants to remain with the Debtors through a transitional period during which the risk of defections is greatest. *See In re Brooklyn Hospital Center*, 341 B.R. at 413; *In re Georgetown Steel Co*., 306 B.R. 549, 556 (Bankr. D.S.C. 2004).

34. In particular, the Debtors filed their chapter 11 cases with a comprehensive and extensive restructuring plan already in place that was agreed to by a majority of the Debtors' prepetition secured creditors and prepetition senior bondholders. *Id* at ¶6 and First Day Decl. at ¶ 2. The Debtors, together with 68.14% of their prepetition secured lenders and 72.55% of their prepetition senior bondholders (collectively, the "**Consenting Creditors**") entered into the RSA. Pursuant to the RSA, the Debtors are under a strict timeline to complete these chapter 11 cases. *See* First Day Decl. at ¶ 60. Thus, the Debtors already have an obligation and commitment to a majority of their prepetition creditors to obtain approval of a disclosure statement by August 31, 2012 and to consummate a plan of reorganization by December 15, 2012. *Id*. Thus, there is no additional incentive necessary, nor any justification, to provide additional compensation to the KEIP Executives in the form of the KEIP bonuses. The KEIP appears to be little

more than the Debtors "encouraging" certain insiders with substantial additional compensation to continue to work in their current positions for a few more months – something clearly restricted under section 503 (c) (1) of the Bankruptcy Code.

35. Furthermore, the target Date of Consummation in the KEIP is also December 15, 2012, the same target Date of Consummation contained in the RSA. *See* Motion at ¶ 21. Thus, the Debtors are not attempting to incentivize the KEIP Executives to achieve a new target Date of Consummation; rather, the KEIP is primarily retentive in nature for the KEIP Executives to remain with the Debtors as the process completes its natural course of action with targets that have not changed since the Petition Date.

36. In the absence of establishing any meaningful, challenging targets to the KEIP Executives, the KEIP cannot be characterized as an incentive plan. Rather, the Debtors should label it what it truly is, a retention plan to provide excessive compensation for several key insiders to remain with the Debtors until they complete the restructuring process that is already in place with targets that are easily reachable.

37. The KEIP also provides for a Financial Performance Award upon achieving certain Cumulative Net Cash Flow levels in the short term. There is no evidence, however, that these targeted levels are at all challenging, let alone a stretch, for the KEIP Executives to achieve. Thus, the Financial Performance Bonus is likewise an improper basis for the KEIP because it is not tied to meaningful and challenging targets.

38. Having determined that the KEIP is a retention based plan for insiders, the next step is to determine whether the Debtors have satisfied the statutory

requirements of Bankruptcy Code section 503(c)(1).[5] Indeed, the Debtors have not even attempted to establish that any elements of the statute have been met and, clearly, the proposed KEIP does not satisfy section 503(c)(1). Among other things, there is no evidence that the proposed awards are essential to the retention of each KEIP Participant, that any participant has a bona fide job offer at the same or greater rate of compensation, or that the services of each participant are essential to the survival of the business. Moreover, there is no evidence that the proposed award amounts fall within the compensation parameters set forth in section 503(c)(1)(C)(i) or (ii).

39. For the foregoing reasons, the KEIP is a disguised retention plan that is prohibited by section 503(c)(1). Accordingly, the KEIP should not be approved.

B. Implementation of the KEIP is Not a Sound Exercise of the Debtors' Business Judgment nor Justified by the Facts and Circumstances of the Chapter 11 Case

40. In the event the Court determines that the KEIP is, in fact, an incentive plan not governed by the specific requirements of section 503(c)(1), it should nevertheless be denied because the proposed payments are "not justified by the facts and circumstances of the case" as required by § 503(c)(3) nor is the decision to make the bonus payments an exercise of sound business judgment.

41. True incentive based bonuses to insiders that are "ordinary course transactions" are subject to the "valid business purpose" test under section 363 of the Bankruptcy Code and must have a good faith and reasonable basis. *See In re Mesa Air Group, Inc.*, 2010 WL 3810899 at *3 (Bankr. S.D.N.Y. 2010). However, incentive based bonuses to insiders that are outside the ordinary course are subject to a heightened degree

[5] It is clear, and the Debtors do not deny, that all of the KEIP Executives, each of whom are either an officer, director, or a person in control of the debtor, are insiders within the meaning of section 101(31) of the Bankruptcy Code. *See* 11 U.S.C. § 101(31). *See* Motion at ¶ 18

of scrutiny under section 503(c)(3) and must be justified by "the facts and circumstances of the case." *Id.* at 2; *Pilgrim's Pride*, 401 B.R. at 236. Under section 503(c)(3), "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." *Id.* at 237; s*ee also Dana I*, 351 B.R. at 100-101 (stating section 503(c) "makes abundantly clear that, to the extent a proposed transfer falls within sections 503(c)(1) or (c)(2), then the business judgment rule does not apply, irrespective of whether a sound business purpose may actually exist."); *but see Velo Holdings*, 2012 WL 2015870 at *9.

42. The Debtors do not argue that the KEIP is an ordinary course transaction. Instead, they seek approval of the KEIP as a transaction outside the ordinary course of business but incorrectly rely on the business judgment analysis applicable to transactions governed by § 363 to support the relief requested. *See* Motion ¶ 42. Alternatively, the Debtors argue the KEIP is authorized under section 503(c)(3) because the payments are "justified by the facts and circumstances." *Id*. at ¶ 60. Both of these arguments fail.

43. Courts considering proposed bonus plans under section 503 (c) (3) have looked at a number of factors, including the following, to determine whether the proposals should be approved: (i) whether the plan is calculated to achieve the desired performance; (ii) whether the plan's cost is reasonable in the context of the debtor's assets, liabilities and earning potential; (iii) whether the scope of the plan fair and reasonable with respect to included (and excluded) employees; (iv) whether the plan is consistent with industry standards, (v) whether the debtor performed due diligence in investigating the need for a plan and determining which key employees needed to be incentivized, and (vi) whether the debtor received independent counsel in developing the plan. *See Dana II*, 358 B.R. at 576-77; *see also, Borders*, 453 B.R. at 474 (applying the Dana II test).

44. Here, the Debtors' Motion should be denied because the proposed KEIP bonuses are unnecessary, excessive and unreasonable. The fact that the Debtors claim to have performed due diligence with respect to the necessity of the KEIP and retained a consulting firm to assist in the development of the KEIP does not overcome the serious flaws in the KEIP.

45. Simply stated, establishing easily reachable and extremely short term targets that would trigger the payment of up to $5.3 million in "incentive" pay to eight executives cannot be justified under any circumstances.

46. Assisting the Debtors in closing either the Standalone Transaction or Third-Party Transaction, both of which are well on their way towards completion, does not constitute a legitimate and meaningful performance target because the KEIP Executives are not required to "stretch" above and beyond in order to reach those goals. Perhaps, if the Standalone Transaction or the Third-Party Transaction were in their formative stages, the implementation of a bonus program to analyze, develop and consummate a transaction could be justified. However, that is not the case here. The Standalone Transaction was fully formed before the commencement of these chapter 11 cases and significant efforts have already been taken in connection with a Third-Party Transaction.

47. Moreover, it is important to note that pursuant to an order ("**PWP Retention Order**") dated May 30, 2012 [Docket No. 174], the Debtors retained Perella Weinberg Partners ("**PWP**") to provide investment banking and financial advisory services and that PRP has been deeply involved in the Standalone Transaction and Third-Party Transaction since prior to the Petition Date. Indeed, pursuant to the PWP Retention

Order, PWP will be paid a handsome $10,000,000 restructuring fee upon consummation of a restructuring and perhaps even more in the event of a sale transaction. Given PWP's lead role in both the restructuring and sales efforts and the substantial fees they will earn upon consummation of either type of transaction, it is difficult to understand why the KEIP Executives should be awarded up to 200% of their base salaries (or approximately $5.3 million) upon consummation of a Standalone Transaction or Third-Party Transaction.

48. As part of their argument, the Debtors attempt to justify the payment of exorbitant bonuses by relying on the fact that the KEIP Executives did not receive bonuses in 2011 because they failed to meet the applicable 2011 performance metrics. *See* Motion at ¶¶ 11, 34. *See also* Declaration of Robert S. Miller in Support of the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Program and the Key Employee Retention Program (the "**Miller Decl**.") at ¶ 11; Declaration of Nick Bubnovich in Support of the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan and Key Employee Retention Plan and Granting Related Relief (the "**Bubnovich Decl**.") at ¶ 13. The failure to meet the prepetition incentive targets in 2011, however, does not justify the implementation of easily reachable targets in 2012.

49. Additionally, the Court should not lose sight of the complete irony and hypocrisy of the Debtors' Motion. The Debtors are attempting to provide excessive bonuses for the eight KEIP Executives while at the same time rank and file jobs are being lost and the Debtors are attempting to terminate pension plans. Pursuant to the tentative agreement with Superior, Superior would not assume any obligations relating to the Debtors' defined benefit pension plans, including the pension plan covering IAM

employees, nor would it assume any obligations for post-employment benefits for their employees. *See* Superior Proposal, ¶ 1. This is in addition to the 800 jobs that the Debtors eliminated prior to the Petition Date and the outsourcing of certain operations. *See* First Day Decl. at ¶ 55. Furthermore, the Debtors and the IAM have been, and are currently, in the process of collective bargaining negotiations in an effort to avoid litigation under section 1113 of the Bankruptcy Code. The negotiations revolve exclusively around the Debtors' proposed termination of their single employer defined benefit plans. Thus, the KEIP clearly discriminates against the Debtors' other employees in favor of eight senior executives and, therefore, should not be approved.

50. The numbers speak for themselves. According to data provided by the Debtors, their current pension plan costs the Debtors approximately $1.59 per hour, per IAM-represented employee. Upon analysis of the Debtors' proposal to replace the current defined benefit pension plan with a defined contribution plan, the proposal would cost the Debtors $1.41 per hour, per employee. Based upon the current level of employment of approximately 2,000 IAM-represented employees, each working 2080 hours per year, the Debtors are seeking to save $748,800 per year in pension contributions.[6] These savings, the Debtors allege, are necessary to properly emerge from bankruptcy as a healthy reorganized company. However, pursuant to the Motion, the Debtors are simultaneously asserting that they can afford to pay eight executives over $5.3 million ($7.2 million if you include the $1.9 million under the KERP). If the Debtors would allocate the funds they are proposing to pay in bonuses to pension contributions for IAM-represented employees under their existing plan, the Debtors

[6] The difference between the Debtors' current pension costs of $1.59 per hour per employee and their proposed pension cost of $1.41 per hour per employee is $.18. $.18 multiplied by 2080 hours per year is $374.4 per employee, per year. The Debtor currently has approximately 2,000 employees in the IAM represented bargaining unit. Thus, $374.4 multiplied by 2,000 employees amounts to a cost savings of $748,800.00 per year to fund the pensions.

would be able to maintain their pension contributions at the current rate of $1.59 per hour, per employee level for over 9.5 years![7]

51. Thus, it is clear that the Debtors are seeking to unfairly discriminate in favor of certain high level employees at the expense of their rank-and-file employees. Providing certain employees with excessive, easy to reach bonuses, while simultaneously seeking eliminate jobs and reduce pension obligations to others, is certainly not fair and reasonable.

52. In sum, to the extent that sections 503(c)(3) or 363 apply, the Debtors have not made a sufficient showing that implementation of the KEIP is justified by the facts and circumstances of the chapter 11 case or that it is an exercise of sound business judgment. Therefore, the Motion should be denied.

C. The KERP Should Not Be Approved Because It Is Not Justified By the Facts and Circumstances of the Case

53. The KERP, like the KEIP, should not be approved because it is "not justified by the facts and circumstances of the case" as required by section 503(c)(3) of the Bankruptcy Code.

54. In support of the proposed $1.9 million KERP, the Debtors' make the typical argument that the retention of the eligible participants is necessary to avoid the loss of important employees at a critical point in the case. *See* Motion, ¶ 50.

55. The Debtors', however, fail to present any evidence - as opposed to generalized assertions - that the implementation of the KERP (which would pay an average of approximately $61,000 to each participant) is necessary to avoid attrition by any of the 31 KERP Participants. There is no evidence that there has been attrition by

[7] $7,228,000.00 divided by $748,800.00 payment per year equals 9.65 years.

key personnel nor is there any evidence that a real threat exists that any of the 31 KERP Participants will resign absent the implementation of the KERP.

56. Furthermore, the Motion fails to disclose the names of the KERP Participants, the specific functions and duties they perform or their current compensation levels. Absent this information it is impossible to assess the necessity or reasonableness of the retention program**.**

57. In light of the Debtors' failure to meet their evidentiary burden, the KERP should not be approved**.**

Conclusion

58. For the reasons stated herein the IAM respectfully requests that the Court deny the Motion.

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