IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	Case No. 11-10884 (MFW)
HARRY AND DAVID HOLDINGS, INC. *et al.*,[1]	)	(Jointly Administered)
	)	Honorable Mary F. Walrath
Debtors.	)	
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THE PENSION BENEFIT GUARANTY CORPORATION'S SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO THE DEBTORS' MOTION FOR AN ORDER (A) DETERMINING THAT THE FINANCIAL REQUIREMENTS FOR A DISTRESS TERMINATION OF THEIR DEFINED BENEFIT PENSION PLAN ARE SATISFIED AND (B) APPROVING A DISTRESS TERMINATION OF THE PENSION PLAN

The Pension Benefit Guaranty Corporation ("PBGC"), pursuant to the Scheduling Order (Docket No. 400), files this brief supplementing its objection ("Objection") (Docket No. 424) to the Debtors' above-mentioned Distress Motion (Docket No. 278). This Court should deny the Motion because the Debtors have failed to show the severe financial hardship necessary under the Employee Retirement Income Security Act ("ERISA") for the Court to approve a distress termination of the Harry & David Employees Pension Plan ("Pension Plan").

PRELIMINARY STATEMENT

The Debtors and their equity investors ("Equity Investors")[2] would have the Court rewrite ERISA to allow distress terminations in chapter 11 reorganizations, not to ensure the

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[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's tax identification number, are: Harry and David Holdings, Inc. (4389), Harry and David (1765), Harry and David Operations, Inc. (1427), Bear Creek Orchards, Inc. (7216), The address for each of the Debtors is: 2500 South Pacific Highway, Medford, Oregon 97501.

[2] Equity Investors include Wasserstein & Company, L.P. and affiliates ("Wasserstein"), and the other parties to the Backstop Agreement, as described below.

continuation of pension plans in all but the most dire circumstances (as Congress intended), but instead to protect equity investors from potential losses, no matter how unlikely. In this case, the Equity Investors – the same entities that hold a majority of the Debtors' Senior Notes – have simply demanded that the Pension Plan be terminated, despite the fact that keeping the Pension Plan would [REDACTED] percent, and when the risk of not meeting their business plan is, [REDACTED] Without any supporting analysis to show that the Pension Plan is unaffordable, the Debtors are asking the Court to rubber stamp the Equity Investors' determination that the Pension Plan must be terminated for there to be a plan of reorganization. Such a concession would create a dangerous precedent by allowing employers and their investors to dump pension liabilities onto PBGC's federal insurance funds even when pension plans are easily affordable.

Accordingly, this Court should find that the Equity Investors' demand for termination of the Pension Plan does not qualify as distress under ERISA, and thus should deny the Motion.

I. FACTS AND PROCEDURAL BACKGROUND

A. Facts

1. Wasserstein's History with Harry & David

In 2004, Wasserstein and its affiliates incorporated Harry & David Holdings, Inc. ("Holdings") to acquire Harry & David (the "Company") from Yamanouchi Consumer, Inc. for approximately $252.9 million.[3] In connection with the 2004 acquisition, Holdings issued to Wasserstein and its junior investment partner, Highfields Capital Management LP

[3] *See* Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for the Second Amended Joint Plan of Reorganization of Harry & David Holdings, Inc. And Its Debtor Subsidiaries (Docket No. 504) ("Disclosure Statement") at Section IV.A.

("Highfields"), one million shares of $.01 par value stock.[4] Debtors also agreed to pay to Wasserstein and its investment partner a fee of up to $1 million annually, plus expenses, for financial management, consulting, and advisory services.[5]

In 2005, Harry & David issued $245 million of bonds and, with the proceeds, paid off its debt from the 2004 acquisition, and paid $82.6 million in dividends to Wasserstein and other investors.[6] Later in 2005, Wasserstein received another $19 million in dividends.[7]

In its 2010 filings with the Securities Exchange Commission, Holdings stated,

> Wasserstein, together with current and former employees of Harry & David, currently owns approximately 66% of our common stock and . . . alone or together with Highfields, will effectively be able to control . . . the Company's affairs and policies, the election of our directors and the appointment of the Company's management. A majority of the members of the board of directors are currently representatives of Wasserstein.[9]

Immediately prior to the March 28, 2011, bankruptcy filing ("Petition Date"), Wasserstein owned 63% of Holdings.

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[4] *Id.*
[5] *See id.*
[6] *See* Ex. A, Harry & David Holdings, Inc. 2006 10-K at 23; *see also* Ex. B, Harry & David Holdings, Inc. 2006 S-4 at 63.
[7] *See* Ex. B, 2006 S-4 at 51 & F-35.
[8] *See* Ex. C, Majoros Dep. 24:6-16, June 28, 2011.
[9] *See* Ex. D, Harry & David Holdings, Inc. 2010 Form 10-K, at 34.
[10] *See* Ex. C, Majoros Dep. 14:7-14; 26:8-19. *Id.* at 27:5-10; *see also* Ex. E, Hong Dep. 19:8-20, July 8, 2011.
[11] *Id.* at 27:23-28:1.

2. Shopping for Financing and Negotiations with Wasserstein and other Equity Investors

Due to a decline in sales during the 2010 holiday season, the Debtors faced a liquidity shortfall and began to consider alternative sources of financing.[12] [redacted] the Debtors, with the assistance of their financial advisor, Rothschild, Inc. ("Rothschild"), began a process to secure debtor-in-possession and exit financing.[13]

[redacted]

[redacted] or

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[12] *See* Distress Motion, Ex. A, Hong Decl. at ¶¶ 26-28, March 28, 2011.
[13] *See* Distress Motion, Ex. C, Augustine Decl. at ¶ 10; Hong Decl. at ¶9; *see also* Ex. F, Augustine Dep. 81:9-16, June 29, 2011.
[14] *See* Ex. G, March 2011 Business Plan. [redacted] *See* Ex. H, January 2011 Business Plan.
See Ex. E, Hong Dep. 56:11-15; Augustine Dep. 107:25, 108:1-3.
[16] *See* Ex. E, Hong Dep. 77:9-24
[17] *See* Ex. E, Hong Dep. 77:25; 78:1-3; *see also* Ex. I, Lampe Dep. 95:12-13; 96:2-7, July 6, 2011.
[18] *See* Ex. E, Hong Dep. 77:2-8.
[19] *See* Augustine Decl. ¶¶ 17, 19, 21-22; Ex. F, Augustine Dep. 125:23-25; 126-130; 131:1-20.
[20] *See* Ex. E, Hong Dep. 92:20-25; 93:3-5.

The marketing process resulted in proposals from Debtors' existing lenders and the Equity Investors.[24] The Equity Investors ultimately provided a $55 million second lien DIP and exit facility (along with UBS/Ally, which provided a $100 million DIP and exit facility).[25]

3. The Backstop Agreement and the Pension Plan Termination Condition

In March 2011, the parties began negotiating the terms of this exit financing, which included a Plan Support Agreement and Backstop Purchase Agreement.

[21] *See id.* at 93:13-19.
[22] *See id.* at 95:22-25; 96:1-5.
[23] *See id.* at 93:5-9.
[24] *See* Hong Decl. ¶ 29; Augustine Decl. ¶ 11.
[25] *See id.*
[26] Ex. J,
[27] Ex. K,
Ex. M, March 21, 2011,
Ex. N

B. The Motion Seeking Distress Termination.

On May 9, 2011, Debtors filed the Distress Motion and a Notice of Motion and Hearing (Docket No. 278). On May 19, 2011, Debtors filed a notice scheduling a hearing with respect to

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[29] *Id.*

[30] *See* Ex. O, Ex. P, Ex. Q, Ex. R, Ex. S, Ex. T, Ex. U, Ex. V,

the Distress Motion for June 24, 2011, with responses or objections due on June 3, 2011 (Docket No. 349). On May 26, 2011, the Court held a status conference at which it approved a schedule setting various discovery deadlines, and providing that PBGC file an initial objection to the Motion on June 7, 2011, and a supplemental objection on July 13, 2011. An evidentiary hearing is set for July 22, 2011.

C. The Pension Plan

PBGC estimates the Pension Plan's unfunded benefit liabilites at $33,419,566.[32] The projected minimum funding contributions owed to the Pension Plan under the Internal Revenue Code and ERISA for the five years ending 2011 through 2016, on a pre-tax basis, are estimated to be $25,514,885.[33] However, the projected minimum funding contributions owed to the Pension Plan for the next five years are $17.5 million, on an after-tax basis.[34] Annually, the after-tax amounts are as follows: $2.9 million in fiscal year 2012, $5.0 million in fiscal year 2013, $3.8 million in fiscal year 2014, $3.4 million in fiscal year 2015, and $2.4 million in fiscal year 2016.[35]

II. STATUTORY BACKGROUND

In Title IV of ERISA, Congress mandated that one of the three primary missions of PBGC is "*to encourage the continuation and maintenance of voluntary private pension plans* for

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[32] *See* Ex. W, Ranade Decl. at ¶ 7, July 13, 2011.
[33] *See id.* at ¶ 11.
[34] *See* Ex. X, Genereux Decl. at ¶ 7, July 13, 2011. Contributions paid to the Pension Plan are tax deductible. *See* 26 U.S.C. § 404.
[35] *Id.*

the benefit of their participants."[36] Another of these missions is to maintain premiums for PBGC's insurance program at the lowest possible level.[37]

To these ends, Title IV of ERISA provides the exclusive means for terminating a defined benefit pension plan.[38] A standard termination requires a plan to have sufficient assets to pay all of the pension plan's promised benefits.[39] A distress termination requires a showing, among other things, that each plan sponsor and controlled group member satisfies one of the statutory financial distress criteria.[40]

Under ERISA's distress termination provisions, a pension plan may terminate only if, *inter alia*, PBGC determines that the requirements of 29 U.S.C. § 1341(c)(2)(B) have been met.[41] The Debtors seek to terminate the Pension Plan under the "Reorganization in Bankruptcy" test ("Reorganization Test").[42] Under that test, a bankruptcy court is called upon to make a factual determination whether a debtor "will be unable to pay all of its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 termination process" unless the pension plan is terminated.[43] The bankruptcy court's determination does not effectuate termination of the pension plan. Instead, PBGC determines

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[36] 29 U.S.C. § 1302(a)(1) (emphasis added).
[37] *Id.*
[38] *See* 29 U.S.C. § 1341(a)(1); *see also Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999).
[39] *See id.* § 1341(b)(2)(A)(i)(III).
[40] *See id.* § 1341(c)(2)(B).
[41] *See id.* § 1341(c)(1).
[42] *See id.* § 1341(c)(2)(B)(ii).
[43] *See id.* § 1341(c)(2)(B)(ii)(IV); 29 C.F.R. § 4041(c)(2)(iv); *see also In re Kaiser Aluminum Corp.*, 456 F.3d 328, 334 (3d Cir. 2006); *U.S. Airways*, 296 B.R. 734, 743 (Bankr. E.D. Va. 2003); *In re Sewell Mfg. Co.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996).

whether the distress requirements are met, and that determination hinges, *in part*, on whether the bankruptcy court makes the requisite factual finding.[44]

III. ARGUMENT

A. The Debtors Have Failed to Satisfy the "Reorganization Test" For a Distress Termination of the Pension Plan Under ERISA

1. The "Reorganization Test" for a distress termination of a pension plan under ERISA is extremely rigorous.

The Debtors bear the burden of proving that they satisfy the Reorganization Test, and that burden is high.[45] It requires a showing that *"but for* the termination of the pension plan, the debtor will not be able to pay its debts when due and will not be able to continue in business."[46] Moreover, "[t]he reference in the statute to 'a' plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan."[47] The Court's inquiry must focus on whether the Debtors will be unable to pay their debts and continue in business with the Pension Plan ongoing under *any* plan of reorganization, not just the particular plan of reorganization that has been proposed.[48] Thus, a particular plan of reorganization cannot dictate the termination decision.

The Report of the House Committee on Education and Labor shows that the "policy of the legislation is to limit the ability of plans sponsors to shift liability for guaranteed benefits

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[44] 29 U.S.C. § 1341(c); 29 C.F.R. 4041.41(a)(1)-(3); *see also Kaiser*, 456 F.3d at 334.

[45] *In re Wire Rope Corp. of Am., Inc.*, 287 B.R. 771, 777 (Bankr. W.D. Mo. 2002); *US Airways*, 296 B.R. at 743.

[46] *In re Resol Mfg. Co.*, 110 B.R. 858, 862 (Bankr. N.D. Ill. 1990) (emphasis added); *see also*, *US Airways*, 296 B.R. at 743; *In re Philip Servs. Corp.* 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004); *Wire Rope*, 287 B.R. at 777-78; *Sewell*, 195 B.R. at 184.

[47] *US Airways*, 296 B.R. at 743-44; *Philip Servs.* 310 B.R. at 808; *see also Wire Rope*, 287 B.R. at 777-78.

[48] *Sewell,* 195 B.R. at 184.

onto other PBGC premium payers and to avoid responsibility for the payment of certain nonguaranteed benefits, to cases of severe business hardship."[49] The House Report further explained a primary purpose for the distress termination provisions was "to provide for the transfer of unfunded pension liabilities onto the single-employer pension plan termination insurance system only in cases of severe hardship so as to keep the premium costs of such system at a reasonable level."[50]

In fact, many companies have kept their pension plans following reorganization in a chapter 11 proceeding. Examples of such companies include the following:

- AbitibiBowater Inc. (Forest Products) – Greenville, SC., 9,800, participants
- American Commercial Inc. (Mikasa) (Retail) – Secaucus, N.J ., 700 participants
- American Safety Razor (Consumer Products) – Cedar Knolls, N.J., 1500 participants
- Chemtura Corporation (Chemicals) – Philadelphia, Pa., 15,000 participants
- Education Resources Institute (Financial Institutions and Services) – Boston, Mass., 120 participants
- General Growth Properties (Financial Institutions and Services) – Chicago, Ill., 130 participants
- Hawaiian Telecom (Telecommunications and Cable) – Honolulu, Hawaii, 1700 participants
- Innovative Communications Corp. (Telecommunications and Cable) – U.S. Virgin Islands, 1,000 participants
- Visteon Corp. (Auto Parts) – Van Buren Township, Mich., 23,000 participants.[51]

Therefore, the fact that a company must reorganize in bankruptcy does not require that they dump their defined benefit pension plans.

[49] H.R. Rep. No. 99-300, at 279 (1985), *as reprinted in* 1986 U.S.C.C.A.N. 810, 930.
[50] *Id.* at 278; *see also US Airways*, 296 B.R. at 743; *Wire Rope*, 287 B.R. at 777.
[51] *See*, e.g., PBGC Press Release dated March 30, 2011, "PBGC Helps Preserve Pensions for 53,000 People in the First Quarter," available at http://www.pbgc.gov/news/press/releases/pr11-29.html.

2. Assuming that the Pension Plan Termination Condition is Not Present or is Waived by the Investors, the Debtors Can Easily Afford the Cost of Maintaining the Pension Plan.

a. Sufficient cash flows support the Pension Plan.

Nothing in the record suggests that if the Debtors maintained the Plan they would be unable to pay their debts, let alone be forced to liquidate. [REDACTED] In fact, the Debtors' projected free cash flow for the next five years is substantially in excess of projected minimum funding contributions to be paid to the Pension Plan.[53]

[REDACTED]

In *Philip Services,*[56] the cost of the company's pension plan was but a small fraction of the company's net cash provided by operations. The court concluded that "payment of these

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[52] *See* Ex. F, Augustine Dep. 95:13-25.

[53] *See* Exhibit III to the Debtors' Disclosure Statement on June 7, 2011 (Docket No. 429); *see also* Ex. X, Genereux Decl. at ¶ 7. This does not even take into account potential additional cash flow as a result of minimum funding waivers. Minimum funding waivers would allow the Reorganized Debtors to defer minimum funding payments into the future, assuming certain requirements are met. *See* Rev. Proc. 2004-15, 2004-1 C.B. 490.

[54] *See* Ex. F, Augustine Dep. 67:16-19; 70:7-25; 71:1.

[55] *See* Ex. X, Genereux Decl. at ¶ 8.

[56] 310 B.R. 802 (Bankr. S.D. Tex. 2004).

pension obligations did not make the plan impossible, it merely makes the cost slightly higher to the Investor."[57] Therefore, the court in that case found that the company's pension obligation over four years "was not a straw that would break the camel's back."[58]

Similarly, in this case, the cost of maintaining the Debtors' Pension Plan is a mere fraction of free cash flow. In short, the Company can easily afford the Pension Plan, even in the tightest months, and still retain its minimum projected liquidity of .

b. Debtors have failed to show that the Pension Plan is not affordable.

Debtors have put forth no evidence or testimony to suggest that the Pension Plan is not affordable in their Distress Motion, and have not challenged PBGC's conclusion that the Pension Plan is affordable. Thus, the Debtors have failed to prove that the Company cannot afford the Pension Plan under its proposed

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[58] *Id.*
[59] *See* Ex. E, Hong Dep. 51:19-20.
[60] *See id.* at 93:3-12.
[61] *Id.* at 93:13-25; 94:1.
[62] *See* Ex. F, Augustine Dep. 95:13-25.

capital structure. They are instead merely hiding behind the Equity Investors' unreasonable demand that the Plan be terminated, notwithstanding its affordability.

3. The Equity Investors' Condition that Pension Plan Terminate is Unreasonable

Unable to prove that the Debtors could continue in business but for the Pension Plan, the Debtors' insist that there cannot be "a" plan of reorganization that will pay their debts because the Equity Investors have conditioned their participation on Pension Plan termination. Rothschild asserts that it is unreasonable to expect *any* investor to commit to the Debtors $55 million in new equity absent termination of the Pension Plan.[63] Rothschild offers no basis for its opinion beyond the Equity Investors' apparent concern that, in a possible subsequent liquidation, "Debtors would face a substantial PBGC obligation overhang that would significantly reduce, or potentially eliminate, the equity returns" if the Pension Plan is not terminated before Debtors' exit from bankruptcy.[64]

The Court should not consider Rothschild's and the Equity Investors' opinions in a vacuum. Rather, in order to test the credibility of these opinions, the Court must consider Rothschild's opinion in the context of the very investment opportunity presented by this case. In particular, if it is to give proper weight to Rothschild's opinion, the Court must consider (a) the returns that an equity investor could reasonably expect to receive on a potential investment in Debtors if their business plan were to succeed with and without termination of the Pension Plan; and (b) the likelihood of a subsequent liquidation in light of Debtors' business plan.

[63] Augustine Decl. at ¶ 21.
[64] *Id*. at ¶ 19.

a.

Another metric that investors use to judge a potential investment's profitability is the investment's projected returns as a multiple of invested capital ("MOIC").[68]

Rothschild, in its declaration, failed to cite to any projections of the returns that an investor in the Debtors could reasonably expect to receive in scenarios with, or without termination of the Pension Plan. The documents produced by Debtors pursuant to PBGC's

[65] *See* Ex. X, Genereux Decl. at ¶ 10. This assumes a sale transaction of June 20, 2016.
[66] *Id.*
[67] Ex. C, Majoros Dep. 51:3-9.
[68] *See* Ex. X, Genereux Decl. at ¶ 10.
[69] Ex. C, Majoros Dep. 51:3-9.
[70] *See* Ex. X, Genereux Decl. at ¶ 10. This assumes a sale transaction date of June 30, 2016.

discovery request show no projections of such returns, either. And neither Wasserstein nor Lampe Conway & Company, LLC, ("Lampe") the potential sources of the largest equity investments in the Debtors, has produced any documents that contain their projected IRRs or MOICs, despite PBGC's specific and repeated requests for all returns analyses considered in reference to, among other investment opportunities, their participation in the Rights Offering.[71]

Thus, it seems that rather than the Equity Investors actually analyzing whether maintaining the Pension Plan actually poses a significant risk to the returns on their investments, they are attempting to insulate themselves from risk, no matter how small, at the expense of PBGC's pension insurance program.

b. The Likelihood of a Subsequent Liquidation Is Low Under Debtors' Business Plan

Debtors place much emphasis on the risk of a subsequent liquidation and the loss of equity value to the Equity Investors as a result. However, while noting every business plan has inherent risks, the Debtors' assertion is that *their* proposed plan of reorganization, at whose heart lies *their* business plan, is *feasible* in the context of section 1129(a)(11) of the Bankruptcy Code, i.e., that it is not likely to result in liquidation or further reorganization.[72]

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[71] Ex. Y, PBGC Subpoena of Wasserstein at 5, June 3, 2011; Ex. Z, PBGC Subpoena of Lampe at 5, June 3, 2011. Ex. AA, Email from Seth Goldman, Munger, Tolles & Olson LLP to Marc Pfeuffer, PBGC, (July 13, 2011, 17.46 EDT).

[72] *See* Disclosure Statement at Section VII.D.

[73] *See* Ex. E, Hong Dep. 38:23, 39:7, 39:19, 40:10, 40:22, 68:15-25.

Even assuming a liquidation were to occur, no evidence has been produced that the Equity Investors did any meaningful analysis of the likely impact of an ongoing Pension Plan to equity's recovery in a possible subsequent liquidation. The best indication of their understanding of the effects of a possible subsequent liquidation, concurrent with their investment decisions, is

4. Equity Investors Cannot Dictate Pension Plan Termination.

The essence of Debtors' argument is that the Pension Plan must terminate because their investors, mainly Wasserstein, said that it must. Debtors argue that (1) their investors will not

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[74] *Id.* at 87:13.
[75] Ex. R, (emphasis added). Ex. C, Majoros Dep. 128:15 – 133:6; Ex. I, Lampe Dep. 92:13 – 94:25, Ex. R,

provide the $55 million in financing, as contemplated in the plan of reorganization, unless the Pension Plan terminates, (2) that there is only one plan of reorganization in prospect, and (3) no plan of reorganization will be consummated if the Distress Motion is not granted. The Debtors therefore assert that the distress termination is necessary so that they can pay their debts under a plan of reorganization. These are exactly the same facts and arguments presented to and rejected by the court in *In re Philip Services Corp*.[77]

Finding that there is not "a" possible plan reorganization that would allow the Debtors to pay their debts (simply because the Equity Investors want to further minimize the already vanishingly small risk) would not only allow investors to hold the pension insurance system hostage, but it would be "tantamount to allowing the investor to make the decision reserved to the bankruptcy court under ERISA."[78] In *Philip Service*s, finding that pension plan termination was not necessary, the court held that, "in determining whether a pension plan must be terminated as a distress termination, the bankruptcy judge should consider the provisions of a proposed chapter 11 plan (if one has been proposed at the time of the decision) but that the bankruptcy judge must also look *to existential financial reality and try to judge whether the plan provisions are necessary or whether they are merely desired by the entities that would benefit from the termination*."[79]

In this instance, the Equity Investors stand to make [REDACTED] while the Debtors' liquidation in this bankruptcy would likely result in no return. It is highly improbable that the Equity Investors, who currently stand to lose their entire investment if the Debtors liquidate, would abandon this

[77] 310 B.R. 802, 807-808 (S.D. Tex. 2004).
[78] *Id.*
[79] *Id.* (emphasis added).

opportunity to earn a [redacted]

[redacted] The Debtors are simply trying to take advantage of the distress termination process to opportunistically [redacted]

Consequently, as the court found in *Philip Services,* the Equity Investors' insistence that they will not provide equity absent a Pension Plan termination is not persuasive, but rather "self-serving, speculative, and hedged."[80] As in *Philip Services,* payment of the pension obligations in this case does not make keeping the pension plan impossible; it merely makes the risk to investors slightly higher.[81] Accordingly, the *Philip Services* court, in finding that the investors' mere wishes of a best case risk scenario was insufficient to show that the debtors would not be able pay their debts pursuant to "a" plan of reorganization, denied debtors' distress termination motion. This Court should find likewise.[82]

B. The Cases Cited by the Debtors are Inapposite to the Circumstances of This Case.

Debtors' cite several cases to support their termination motion. However, unlike *Philip Services,* which is almost identical to the case at hand, those cases are inapposite.

1. *In re Falcon Products, Inc.*

Debtors' reliance on *In re Falcon Products, Inc.*,[83] is misguided because the facts in that case are completely distinguishable. In *Falcon*, the debtors testified that the internal rate of return of the investors' $50 million investment under the plan of reorganization – assuming the debtors achieve their projections and the pension plan is terminated -- was only 22%, which was

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[80] *Id*. at 806.
[81] *Id*.
[82] In *Philip Services,* the debtors kept all four of its pension plans which remain ongoing. *See* Ex. BB.
[83] 2005 WL 3416130 (Bankr. E.D. Mo. Oct. 26, 2005), *aff'd*, 497 F.3d 838 (8th Cir. 2007)

below market.[84] Based on this testimony, the court found credible the investors' statement that they would not invest $50 million unless the pension plans terminated.[85] Here, according to PBGC's expert's uncontroverted opinion, even if the Pension Plan does not terminate, the rate of return on Wasserstein's investment [REDACTED][86] And, the Plan Support Agreement and Backstop Agreement provide for treatment of the Pension Plan other than termination. Thus, in light of the [REDACTED] and Wasserstein's equity stake in the Debtors, any statement by Wasserstein that the cost of the Pension Plan justifies a decision not to invest is just not credible.

The *Falcon* court also found that the debtors were insolvent. Their enterprise value was $117 million, but their pre-petition secured debt was $125.7 million and DIP loan was $44.7 million. The debtors were worth less than their secured debt, but the investors were willing to invest in additional equity at a valuation of $145 million.[87] Accordingly, the court found the debtors would not find from another investor the cash needed to survive without pension plan termination.[88] In contrast, here the Debtors had no pre-petition secured debt and funded a DIP of 55 million, far below the estimated enterprise value of as much as $130 million.[89]

Contrary to the instant case, in *Falcon*, the bankruptcy court also found that the debtors "made all meaningful sacrifices they can do to reduce costs before seeking to terminate the Pension Plan."[90] For example, the *Falcon* debtors closed plants, laid off employees, significantly reduced other employee benefits (i.e., dental, disability, medical, and 401(k)), and

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[84] *Id*. at *5, 8.
[85] *Id*. at *8.
[86] *See* Ex. X, Genereux Decl. at ¶ 10.
[87] 2005 WL 3416130 at *4.
[88] *Id*. at *6.
[89] *See* Disclosure Statement, Exhibit IV.
[90] 2005 WL 3416130 at *2

did not implement any key employee retention programs.[91] In *Harry & David*, [redacted]

In fact, the Debtors did not pay the April 15, 2011 quarterly contribution owed to the Pension Plan, as required by the Internal Revenue Code, but yet was able to pay an annual $1 million management fee due to Wasserstein and Highfields.[96]

Instead, the Debtors actually increased their future expenses during the liquidity crisis. Immediately prior to the petition date, the Debtors negotiated a new management services agreement with Wasserstein whereby Wasserstein would be compensated with (i) 50,000 Harry and David shares; and (ii) an annual base management fee worth a maximum of $625,000 if the Debtors achieve adjusted EBITDA targets for rendering management services.[97] At this time, the Debtors also agreed to give Wasserstein up to 10% of Harry and David's shares, in addition

[91] *Id*. at *2-3.
[92] *See* Ex. E, Hong Dep., 92:20-25, 93:3-5.
[93] *See id*. 93:13-22.
[94] *See id.* 94:24-25; 95:1-25; 96:1-5
[95] *See id*. 93:3-12.
[96] *See* Amended Disclosure Statement, Article IV.C at 16; Article VI.K at 35-36.
[97] *See id*. at Article VI.K at 35-36.

to the aforementioned shares and management fee, in connection with a "management incentive plan" to be established by the Board of Directors of the Reorganized Debtors.[98]

2. Other Cases Cited by Debtors

The additional cases cited by Debtors are distinguishable because unaffordability (not the investor's anti-pension-plan requirements) was the principal reason that prevented the debtors from reorganizing and continuing in business outside the chapter 11 process. For example, the companies in *Sewell* and *Wire Rope* did not have sufficient cash flow to pay minimum funding contributions owed to the pension plans on an ongoing basis. In *Sewell,* before taking into account any pension costs, the debtors were projected to suffer a negative cash flow of over $200,000 in the 1996 fiscal year. Yet, the Internal Revenue Code would have required the debtors to contribute $2.3 million to the pension plan by 1996.[99] In *Wire Rope*, the company's projected free cash flow for the following three years (2003-2005) totaled $9.9 million but the minimum funding contributions owed to the pension plan during those same years totaled $16.4 million.[100] Because the pension plans in *Sewell* and *Wire Rope* were clearly not affordable, these cases are not applicable.

In addition, in many of the cases cited by the Debtors, there were multiple pension plans, but the debtors only sought to terminate the plans that were not affordable. *In re Oneida Ltd.*[101] is one of such cases where despite lenders' condition that all three pension plans terminate, Oneida kept two pension plans, and only the largest, most expensive pension plan terminated.[102]

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[98] *See* Plan Support Agreement Term Sheet, Exhibit B to Backstop Motion, Docket 117.
[99] *In re Sewell*, 195 B.R. 180, 182 n.2&3, 185-86 (Bankr. N.D. Ga. 1996).
[100] *In re Wire Rope,* 287 B.R. 771, 776, 779 (Bankr. W.D. Mo. 2003).
[101] Case No. 06-10489 (Bankr. S.D.N.Y. May 6, 2006).
[102] Motion of Debtors for Order Pursuant to 29 U.S.C. § 1341(c)(2)(B)(ii) Determining that Debtors Satisfy Financial Requirements for Distress Termination of Pension Plans an d Approving Termination of Plans ("Oneida Distress Motion") at ¶ 48, Response of the PBGC to

Regardless of what the lenders wanted, the minimum funding contributions owed to the largest plan for the following three years would have subsumed the debtors' cash flow.[103]

Similarly, in *In re US Airways Group, Inc.*,[104] the debtor had four pension plans, but only sought to terminate one. The "lender" in *US Airways*, the Air Transportation Stabilization Board ("ATSB"), did not expressly require the termination of US Airways' pension plan.[105] US Airways' financial advisor testified that, without a "'resolution'" of the pension funding issue that would allow the airline to meet the projections in its business plan, it was unlikely that the ATSB would issue the loan guarantee.[106]

Before seeking the distress termination, US Airways sought to obtain additional savings from its labor force, aircraft lenders, lessors, and vendors -- which resulted in concessions from the pilots union totaling $179 million.[107] US Airways also consulted with PBGC and the Internal Revenue Service in an effort to resolve the pension plan's funding shortfall. Indeed, US Airways went to Congress to seek a legislative solution for the pension plan.[108] Unfortunately, alternative funding relief for the pension plan was not available, and the airline did not have sufficient cash flow to sustain the minimum funding contributions going forward.[109] US

Oneida Distress Motion, and Order Pursuant to 29 U.S.C. § 1341(c)(2)(B)(ii) (I) Determining That Debtors Satisfy Financial Requirements for Distress Termination of Defined Benefit Pension Plans And (II) Approving Termination of Such Pension Plans, In re Oneida, Inc., Case No. 06-10489 (Bankr. S.D.N.Y. May 2, 2006) (Docket Nos. 22, 167, 207).

[103] *See* Oneida Distress Motion, Appendix B; *see also* Second Amended Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for the Debtors' Joint Prenegotiated Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, Exhibit F, In re Oneida, Inc., Case No. 06-10489 (Bankr. S.D.N.Y. May 22, 2006) (Docket No. 245).

[104] 296 B.R. 734 (Bankr. E.D. Va. 2003); *see also* Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001).

[105] *Id*. at 737.

[106] *Id*. at 740.

[107] *Id*. at 738.

[108] *Id.* at 739-41.

[109] *Id*. at 738-41.

Airways turned to pension plan termination only as a last resort for economical survival. And, as the court in *Philip Services* noted, '[i]n *US Airways*, Judge Mitchell went to great pains to explain the overwhelming evidence that the debtor could not survive without termination of the pension plan."[110]

Lastly, several of the cases relied on by the Debtors did not involve a requirement of pension plan termination by an investor. For instance, the Delta Pilots' Retirement Plan ("Pilots Plan") terminated, not because an investor required it, but because of the Pilot Plan's unique lump sum provision allowing pilots, upon retirement, to take 50% of their pension benefit in an up-front, lump sum payment -- which ranged for each pilot between $500,000 and $1,000,000. Because pilots were retiring in droves and taking advantage of the Pilots Plan's lump sum provision, on September 30, 2005, the Pilots Plan suffered a "liquidity shortfall" – meaning the Plan did not have enough liquid assets as required by the Internal Revenue Code. Consequently, the Pilots Plan had to stop paying lump sums to retirees.

In its distress termination motion, Delta stated that, if the Plan emerged from liquidity shortfall and lump sums were once again available, approximately 800 to 1,000 pilots would retire in order to receive a lump sum payment. Delta stated that such a wave of retirements of their most senior pilots would cripple its operations. Delta also said, generally, that no lender would provide exit financing when the possibility of such a crisis existed, whether it actually occurred or not. But, primarily, termination of the Pilots Plan was necessary to foreclose lump sum payments and any possibility of a massive wave of retirements.[111] The bankruptcy court

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[110] *Philip Services*, 310 B.R. at 808.
[111] Motion of the Debtors Seeking a Determination That They Satisfy the Financial Requirements for a Distress Termination of the Delta Pilots Retirement Plan And Approval of Such Termination, In re Delta Air Lines, Inc., Case No. 05-17923 (Bankr. S.D.N.Y. August 4, 2006) (Docket No. 3013).

granted Delta's motion. It should be noted that Delta did not seek termination of its non-pilot defined benefit pension plan, which did not contain any unique lump sum provision and, to this day, remains ongoing.[112]

Again, the facts of the above cases are vastly different from this case. The debtors in those cases had multiple pension plans and the major issue was the debtors' ability to afford the pension plans. Here, the Debtors are attempting to terminate the *only* pension plan they maintain. The Pension Plan is clearly affordable. Consequently, the Debtors reliance on the above cases for support of their Distress Motion is misplaced.

IV. CONCLUSION

For the foregoing reasons, the Court should find that the Debtors have not met the criteria for a distress termination of their Pension Plan and therefore deny their Motion.[113]

[112] *See* Ex. CC.
[113] PBGC expressly reserves all of PBGC's claims, defenses, and rights to assert further objections or supplement current objections to the Distress Motion and modifications thereof if Debtors produce additional, relevant documents. *See* Ex. DD, Email from Debtors' counsel to PBGC counsel, describing discovery production problems.

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Washington, D.C.

Respectfully submitted,

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