

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF KENTUCKY

In re:)
) Chapter 11
)
CONCO, INC.) Case No. 12-34933
)
 Debtor.) Hon. Joan A. Lloyd
)
_____)

**OBJECTION BY PENSION BENEFIT GUARANTY CORPORATION
TO THE DEBTOR’S MOTION FOR ORDER APPROVING
DEBTOR’S NON-INSIDER KEY EMPLOYEE RETENTION PLAN**

Pension Benefit Guaranty Corporation objects to the Debtor’s Motion for an Order Approving the Debtor’s Non-Insider Key Employee Retention Plan (“KERP Motion”) because the Debtor fails to allege sufficient facts to satisfy the standard for judicial review under 11 U.S.C. § 503(c)(3) and the sound business judgment test under 11 U.S.C. § 363(b).

BACKGROUND

1. The Debtor moves the Bankruptcy Court to approve a Key Employee Retention Plan (the “KERP”) under the business judgment test.¹
2. The Debtor represents that certain employees, as identified on Exhibit A to the KERP Motion, “have become insecure about their future with the Debtor and it has forced them to consider alternate employment” because a proposed Plan of Reorganization filed by the Committee of Unsecured Creditors (the “Committee Plan”) provides for an auction of the Debtor’s assets.² The Debtor claims that an auction “amounts to a liquidation of the Debtor.”³ The Debtor fails to provide any evidence supporting the foregoing assertions.

¹ The KERP Motion was filed on August 6, 2014, at Doc. No. 353 and 353-1 (Exhibit A).

² *Id.* at ¶¶ 6-9. Terms not defined herein were defined in the KERP Motion.

³ *Id.* at ¶ 7.

3. The Debtor has identified the affected employees by name and job title. The Debtor alleges that the key employees (singularly “Key Employee,” and together “Key Employees”) have historical and systemic knowledge and have provided valuable essential services to the Debtor on day-to-day basis in areas such as finance and accounting, human resource and plant operations support during the Debtor’s Chapter 11 proceeding and assisted with the Debtor’s bankruptcy reporting obligations.⁴ The Debtor further alleges that if these employees resign earlier than planned, it will not be able to effectively or cost efficiently replace them.⁵ Again, the Debtor fails to provide any evidence supporting these statements.

4. The Debtor seeks approval of a pool in the amount of \$613,477 via funds to be set aside and earmarked out of the Debtor to pay Key Employees who satisfy the KERP’s conditions for payment of a Stay Bonus in the amount of six months’ salary up to a limit of \$50,010. There will be no prorated or partial payment of a Stay Bonus.⁶

5. Although the Debtor states that affected employees will earn a Stay Bonus by continuing to work with the Debtor in the same capacity until either a pre-defined date or until a specific task is completed, the Debtor will in fact only pay the Stay Bonus if its business is sold or liquidated.⁷

6. Key Employees will also be paid a Stay Bonus, if they refuse employment with the buyer or resign their employment with the buyer within 90 days after the effective date of the sale. The Debtor will pay the Stay Bonus within 15 days after the termination of the Key Employee’s employment with the buyer or new owner.⁸

⁴ *Id.* at ¶¶ 10, 13, 15.

⁵ *Id.* at ¶ 14.

⁶ *Id.* at ¶¶ 10, 12, 16, 19-20.

⁷ *Id.* at ¶¶ 10-11, 16.

⁸ *Id.* at ¶ 18.

7. A Key Employee will become ineligible for the Stay Bonus if he or she is terminated for cause, voluntarily resigns before the sale or liquidation of the Debtor, or is not actively employed on the effective date of the sale or liquidation of the Debtor.⁹

STATUTORY FRAMEWORK

8. Section 503(c)(3) of the Bankruptcy Code limits payments made to the debtor's employees outside of the ordinary course of business unless they are justified by "the facts and circumstances of the case."¹⁰ Under Section 503(c)(3), Bankruptcy Courts consider the reasonableness of transactions outside the ordinary course related to the compensation of non-insider employees.¹¹

9. Section 363(b)(1) provides that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."¹² In approving a transaction under Section 363(b)(1), courts consider whether the debtor exercised sound business judgment.¹³

10. The Debtor proposes to pay the bonuses in full and prior to payment of unsecured creditors, and claims that the affected employees provide "essential services" during the administration of the case.¹⁴ Accordingly, while the Debtor does not explicitly so state, it treats

⁹ *Id.* at ¶ 20.

¹⁰ 11 U.S.C. § 503(c)(3); *In re Borders Grp., Inc.*, 453 B.R. 459, 473-75 (Bankr. S.D.N.Y. 2011).

¹¹ *See In re Dewey & LeBoeuf LLP*, 2012 WL 3065275 at *3 (Bankr. S.D.N.Y. July 30, 2012) (denying a discretionary fund for payment of KERP bonuses approved by management, to non-insider employees, but otherwise approving the KERP as reasonable under the circumstances of the debtor's bankruptcy proceeding). *See also In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236-37 (Bankr. N.D. Tex. 2009) (the standard for approval under section 503(c)(3) is higher than the business judgment test; if payments to employees outside the ordinary course were only subject to the business judgment test, then the language of section 503(c)(3) would ostensibly be rendered meaningless).

¹² 11 U.S.C. § 363(b)(1).

¹³ *In re Borders Grp., Inc.*, 453 B.R. at 473.

¹⁴ KERP Motion at ¶¶ 15, 17 (employees will be paid within 15 days of termination or refusal of continued employment), ¶ 19 (funds will be set aside and earmarked for the Stay Bonus).

the proposed payments as an administrative expense under section 503 and section 503(c)(3) applies.¹⁵ That section disallows the payment of such claims unless they are justified by the facts and circumstances of the case.¹⁶

11. At least one court has held that section 503(c)(3) requires a higher standard of proof than the “business judgment test” found in section 363. In *Pilgrim’s Pride*, the Bankruptcy Court for the Northern District of Texas reasoned that the statutory language requiring that a retention program be “justified by the facts and circumstances of the case” suggested a higher standard than the “business judgment” standard found in section 363.¹⁷

12. A number of courts, however, have found the “facts and circumstances” test under section 503(c)(3) to equate to the “business judgment” test in assessing the structure of an employee compensation proposal and the process for its development. In applying the “business judgment test” to KERPs, courts address the following factors, initially described in *Dana II*¹⁸:

— 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?

¹⁵ See *In re Residential Capital, LLC*, 491 B.R. 73, 78-79 (Bankr. S.D.N.Y. 2013) (non-insider retention program treated as an administrative expense considered under section 503(c)(3)); accord *In re Global Aviation Holdings, Inc.*, 478 B.R. 142 (Bankr. E.D.N.Y. 2012), *Dewey & LeBoeuf*, 2012 WL 3065275 at *3.

¹⁶ 11 U.S.C. § 503(c)(3).

¹⁷ *Pilgrim's Pride Corp.*, 401 B.R. 229, 236-37. See *In re CEP Holdings, LLC*, 2006 LEXIS 3305 at *8-9 (Bankr. N.D. Ohio 2006); *In re Supplements LT, Inc.*, Case No. 08-10446 (KJC), Docket No. 227 (Bankr. D. Del. Apr. 14, 2008); *In re Dura Auto Sys., Inc.*, Case No. 06-11202, Doc. No. 1369 (Bankr. D. Del. June 29, 2007). Attached as Exhibits A & B.

¹⁸ *In re Dana Corp.*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006) (“*Dana II*”).¹⁹ *Dana Corp.*, 358 B.R. at 576-77, citing *In re EaglePicher Holdings, Inc.*, 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.2001); *In re America West 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) for the proposition that the courts consider six factors in deciding whether a compensation proposal and the process for developing it satisfy the business judgment test. The Debtor also relies on *EaglePicher Holdings*. KERP Motion, Doc. No. 353 at ¶ 29.

- 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?

These factors were initially applied in *Dana II* to an employee compensation plan outside the ordinary course.¹⁹

13. The *Dana II* factors have also been used by Bankruptcy Courts in reviewing non-insider KERPs under Section 503(c)(3).²⁰

The Debtor Fails to Allege Sufficient Facts to Meet the *Dana II* Factors

14. Even if the business judgment test applies, that test does not give free reign to any decision by the Debtor, as the Debtor seems to suggest. The Debtor failed to even allege sufficient facts to meet its burden to show a reasonable exercise of business judgment, and provided no evidence to support the few facts it did allege.

15. As *Dana II* and its progeny make clear, a Debtor’s decision to implement a KERP must, at a minimum, bear a reasonable relationship to the desired outcome. The Debtor states two purposes for the proposed KERP: (1) to retain employees who have become insecure about

¹⁹ *Dana Corp*, 358 B.R. at 576-77, citing *In re EaglePicher Holdings, Inc.*, 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.2001); *In re America West 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) for the proposition that the courts consider six factors in deciding whether a compensation proposal and the process for developing it satisfy the business judgment test. The Debtor also relies on *EaglePicher Holdings*. KERP Motion, Doc. No. 353 at ¶ 29.

²⁰ *Dewey & LeBoeuf*, 2012 WL 3065275 at *4; *Borders Grp., Inc.*, 453 B.R. at 473.

continued employment after a sale and (2) to maximize value of the estates. The structure of the proposed KERP is not reasonably related to either of these purposes.

16. The Debtor states that employees “have become insecure about their future with the Debtor”²¹ because the Committee’s Plan provides “no long term prospect of employment for Key Employees.”²²

17. The Debtor implies that any sale “amounts to a liquidation of the Debtor”²³ and yet at the same time recognizes that a going-concern sale is possible in referring to the possibility of continued employment by any buyer.²⁴

18. While the Debtor claims that its purpose is to protect its employees from losing their jobs as a result of a sale²⁵, it proposes to pay the bonuses even if an employee is offered continued employment but voluntarily declines the offer. Thus, the proposed KERP is not rationally related to the stated purpose of protecting employees against involuntary job loss.

19. The proposed KERP also fails to maximize the value of the estate.

20. The Debtor claims that these employees are crucial to the success of the company, but the KERP as structured provides an incentive for these allegedly crucial employees to leave the company if it is sold, thus destabilizing the company for any buyer.

21. Providing an incentive for Key Employees to leave if the Debtor is purchased reduces the value of the company to a buyer, which would likely reduce the purchase price at auction. Thus, this KERP is not reasonably related to the stated purpose of maximizing value to the estate.

22. The Debtor has also failed to meet its burden to show that the KERP is reasonably

²¹ KERP Motion at ¶ 9.

²² *Id.* at ¶ 28.

²³ *Id.* at ¶ 7.

²⁴ *Id.* at ¶¶ 18-19.

²⁵ *Id.* at ¶¶ 7, 9, 28.

calculated to achieve its objectives²⁶ by failing to make any showing that these employees are actually “key” employees. The Debtor has not cited any facts regarding the job responsibilities, the job functions performed, salaries, educational and work backgrounds of the Key Employees covered by the KERP.

23. The Debtor has further failed to justify the proposed KERP with any facts as to its rate of attrition before and since the bankruptcy filing among employees as a whole and among Key Employees, the Debtor’s rate of attrition among employees in job categories similar or the same as those held by Key Employees, how many Key Employees are searching for other employment, or how many Key Employees have received other job offers.²⁷

24. The Debtor has not alleged any facts to support its allegation that the employment of each Key Employee is necessary to “stem the loss of historical and systemic knowledge and to aid the Debtor’s efforts to transition to a confirmed plan of reorganization and maximize recovery for the creditors.”²⁸

25. The business judgment test further requires that the Debtor show that the cost of the plan is reasonable in the context of the debtors’ assets, liabilities and earning potential. Nonetheless, the Debtor has failed to allege any facts to support the allegation that \$613,477 of estate assets should be set aside and made available to pay the Stay Bonus to the Key Employees.

26. The Debtor has not alleged any facts as to the value of its assets, liabilities and earning potential.

27. The Debtor has not alleged any facts as to the standards in the defense industry for compensation of employees or KERPs.

28. If an auction of the Debtor’s business or assets is held in October and a sale

²⁶ *Dewey & LeBoeuf* at * 4.

²⁷ *Dewey & LeBoeuf* at *1-2; *Borders Grp., Inc.*, 453 B.R. at 465, 473.

²⁸ KERP Motion at ¶ 10.

closes in November,²⁹ Key Employees need only work for the Debtor 2 to 4 months before the sale closes, but could be paid Stay Bonuses of as much as 6 months' salary up to a limit of \$50,010.³⁰ In contrast, incentives provided for employees in *Dewey* for similar time frames only equaled two to eight weeks' salary, and those employees knew they would be jobless at the end of their tenure, as liquidation was a certainty.³¹ Here, two out of three possible outcomes would likely provide the employees with continued employment.

29. The Debtor has not alleged any facts concerning its effort(s) to investigate the need for a KERP or analyze which Key Employees need to be incentivized to remain in the Debtor's employ.

30. The Debtor has not alleged any facts as to independent counsel, if any, that it received to create and decide the amounts of the Stay Bonus under the KERP.

CONCLUSION

The Debtor's stated objectives are to aid its efforts in transitioning to a confirmed plan of reorganization and maximize recovery for the creditors. The Debtor must show that the KERP is reasonably calculated to achieve these objectives.³² The KERP provides incentives to Key Employees to stay in the Debtor's employ yet the Stay Bonus will be paid only if the Debtor's business or assets are sold in an auction or the Debtor liquidates. This structure is not reasonably calculated to achieve the Debtor's two stated objectives.

Further, absent even the allegation of facts necessary to determine whether the structure of the KERP meets the *Dana II* factors and is reasonably calculated to achieve the Debtor's

²⁹ Motion for Order Approving Auction and Bidding Procedures and Exhibit B thereto, Doc. No. 343 at ¶¶ 27-28 and Doc. No. 343-2 at ¶¶ 8, 11, 14.

³⁰ KERP Motion at 16.

³¹ *Dewey & LeBoeuf* at *2 (decision in late July, 2012 addressed incentives for employees staying periods ranging from through the end of August, 2012 to through the end of December, 2012).

³² *Dewey & LeBoeuf* at *4.

stated objectives, the KERP Motion and the set aside of \$613,477 should be denied. For the forgoing reasons, PBGC requests that the Bankruptcy Court deny the KERP Motion for the reasons stated in this objection.

Dated: August 19, 2014
Washington, D.C.

Respectfully submitted,

/s/ Kimberly E. Neureiter

ISRAEL GOLDOWITZ

Chief Counsel

KAREN L. MORRIS

Deputy Chief Counsel

STEPHANIE THOMAS

Assistant Chief Counsel

JEAN MARIE BREEN

KIMBERLY E. NEUREITER

Attorneys

PENSION BENEFIT GUARANTY

CORPORATION

Office of the Chief Counsel

1200 K Street, N.W.

Washington, D.C. 20005-4026

Telephone: (202) 326-4020, ext. 3581

Facsimile: (202) 326-4112

Email: Neureiter.kimberly@pbgc.gov and efile@pbgc.gov

Attorneys for Pension Benefit Guaranty Corporation

CERTIFICATE OF SERVICE

I hereby certify that on August 19, 2014, a true and correct copy of the foregoing was (a) mailed electronically through the U.S. Bankruptcy Court's ECF system at the electronic addresses as set forth in the ECF system to the U.S. Trustee, and all other persons receiving electronic notifications in this case, and (b) mailed, first-class, postage prepaid, to the Unsecured Creditors Committee and to those persons, if any, identified in the Court's Notice of Electronic Filing who do not receive electronic notice but are entitled to be served.

/s/ Kimberly Neureiter
Kimberly Neureiter