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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In re:	:	Chapter 11
ALUMINUM SHAPES, LLC,	:	Case No. 21-16520 (JNP)
Debtor.	:	Hearing Date: November 12, 2021 at 10:00 a.m.

OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTOR'S EXPEDITED MOTION FOR ENTRY OF AN ORDER (I) APPROVING DEBTOR'S KEY EMPLOYEE RETENTION PLAN, (II) APPROVING DEBTOR'S KEY EMPLOYEE INCENTIVE PLAN, AND (III) GRANTING RELATED RELIEF

Andrew R. Vara, United States Trustee for Regions Three and Nine (the "U.S. Trustee"), files this Objection (the "Objection") to the Debtor's Expedited Motion for Entry of an Order (I) Approving Debtor's Key Employee Retention Plan, (II) Approving Debtor's Key Employee Incentive Plan, and (III) Granting Related Relief (ECF No. 185) (the "Motion"), and in support of that Objection states as follows: [1]

[1] Capitalized terms used herein as defined terms and not otherwise defined shall have those meanings ascribed to them in the Motion.

PRELIMINARY STATEMENT

1. By the Motion, the Debtor seeks Court approval of what it terms a Key Employee Incentive Program (the "KEIP") and a Key Employee Retention Program (the "KERP"). The KEIP, although styled as an incentive bonus program, may in fact be a retention bonus program.

2. The KEIP consists of two (2) tiers of incentives and is based upon the KEIP Target, which is the sale price achieved. *See* ECF No. 185 at page 9 of 21. The KEIP first incentivizes the KEIP Participants by providing them with a KEIP Bonus if a Baseline Target is achieved.[2] *See id.* The KEIP next incentivizes the KEIP Participants to achieve higher KEIP Targets (together with KEIP Target and Baseline Target, the "Targets"), providing additional KEIP Bonuses for every dollar ($1.00) above the Baseline Target achieved:

> Generally, the KEIP provides at a purchase price of the Baseline Target, each KEIP Participant shall receive, on a pro-rata basis, "X" percent (X%) of their total salary; and thereafter, each KEIP Participant shall receive "N" percent (N%) of the net proceeds for every dollar ($1.00) over the Baseline Target not to exceed one hundred percent (100%) of each KEIP Participant's individual total salary.

See id.

3. As the Debtor has filed the Rosenthal Declaration and the Magner Declaration under seal, parties and creditors have no information as to whether the Targets are easily achieved or requires sufficient work on behalf of the KEIP Participants.[3]

[2] The Motion does not include the amount of the Targets or the amounts to be paid under the KEIP and the KERP. Instead, the Debtor filed an Expedited Motion to Seal certain parts of the Motion, more specifically the declarations of Solomon Rosenthal (the "Rosenthal Declaration") and Justin Magner (the "Magner Declaration"), which, if granted, will prevent parties from being informed as to the Targets and payments to be made under the KEIP and the KERP (the "Seal Motion"). A separate objection to the Seal Motion is being filed by the U.S. Trustee.

[3] Upon request by the U.S. Trustee pursuant to 11 U.S.C. 107(c)(3)(A), the Debtor provided the U.S. Trustee with unredacted versions of the Motion, the Rosenthal Declaration and the Magner Declaration. Even with these unredacted pleadings, it is still unclear whether the Targets are easily achieved.

4. The U.S. Trustee objects to the approval of the KEIP because there is insufficient information for the Court to determine whether the proposed metrics with respect to the sale of the Debtor's assets appear to be easily achievable and, as such, may not be truly incentivizing.[4] As such, approval of the KEIP should be denied unless it satisfies Section 503(c)(1).

5. The Debtor also seeks approval of the KERP. There are nine (9) employees of the Debtor who are participants in the KERP. *See id.* at page 13 of 21. The Debtor sets forth that the KERP Participants, to the extent they hold "officer" titles, are officers in name only and none of the KERP Participants are managers of the Debtor or appointed to their position by the owner of the Debtor.[5] *See id.* However, employees with officer and director titles are presumed to be insiders under the Code, unless the Debtor can establish otherwise.

6. Pursuant to Section 503(c)(1) of the Bankruptcy Code, bonus payments to those employees that constitute insiders are subject to a strict standard if they are for the purpose of inducing employees to remain with the Debtor's business. Additionally, bonus payments must result from quantifiable benchmarks that are truly incentive-based and not retention-based.

7. Here, the Debtor argues that § 503(c)(1) does not apply to the KEIP because it is an "incentive" plan, not a "retention" plan. However, if the requirements of § 503(c)(1) of the Code can be evaded simply by creating "incentives" based on a Baseline Target without any justification or disclosure, then section 503(c)(1) has been all but written out of the Bankruptcy Code.[6]

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[4] Section 2.5 of the APA sets forth that the purchase price is $20 million plus assumed liabilities. However, neither the APA nor the Sale Motion provide any hints as to the cost for the assumed liabilities. As such, it is difficult to determine whether the KEIP Target, Baseline Target and/or other higher KEIP Targets are easily achieved or not.

[5] The Debtor failed to include the titles of the KERP Participants in the Motion.

[6] As justification for the KEIP, the Debtor provided the following: "The Debtor submits that meeting any of the KEIP Targets, even the Baseline Target, would be a significant achievement meriting the payment of the KEIP Bonuses. To earn their KEIP Bonuses, the KEIP Participants must continue business operations in a manner that

8. For these reasons, which are set forth in more detail below, the U.S. Trustee respectfully requests that the Debtor's Motion be denied.

JURISDICTION

9. Under (i) 28 U.S.C. § 1334, (ii) applicable order(s) of the United States District Court for the District of New Jersey issued pursuant to 28 U.S.C. § 157(a), and (iii) 28 U.S.C. § 157(b)(2), this Court has jurisdiction to hear and determine the Motion and this Objection.

10. The U.S. Trustee is charged with overseeing the administration of Chapter 11 cases filed in this judicial district, pursuant to 28 U.S.C. § 586. This duty is part of the U.S. Trustee's overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts to guard against abuse and over-reaching to assure fairness in the process and adherence to the provisions of the Bankruptcy Code. *See In re United Artists Theatre Co.*, 315 F.3d 217, 225 (3d Cir. 2003) ("U.S. Trustees are officers of the Department of Justice who protect the public interest by aiding bankruptcy judges in monitoring certain aspects of bankruptcy proceedings."); *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 298 (3d Cir. 1994) ("It is precisely because the statute gives the U.S. Trustee duties to protect the public interest . . . that the Trustee has standing to attempt to prevent circumvention of that responsibility."); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("As Congress has stated, the U.S. trustees are responsible for 'protecting the public interest and ensuring that the bankruptcy cases are conducted according to [the] law").

ensures the continued success of the Debtor and go above and beyond in their efforts to market to and work with potential purchasers. As a result, KEIP Participants have a strong incentive to generate substantial value for the Debtor's estate." *See id.* at page 17 of 21.

11. Under section 307 of title 11 of the United States Code (the "Bankruptcy Code" or "Code"), the U.S Trustee has standing to be heard on the Motion and the issues raised in this Objection.

BACKGROUND

12. On August 15, 2021 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code. *See* ECF No. 1.

13. The Debtor remains in possession of its assets and continues to manage its business as a debtor-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

14. The U.S. Trustee appointed an Official Committee of Unsecured Creditors on September 1, 2021. *See* ECF No. 77.

15. On October 19, 2021, the Debtor filed this Motion, seeking authorization to implement the KEIP and the KERP. The Debtor publicly disclosed that the KEIP covers 4 employees whom the Debtor describes as "insiders." The Debtor also seeks to authorize implementation of the KERP for nine (9) employees whom the Debtor asserts are not insiders but acknowledges at least some may have officer or director titles.

16. The Debtor has redacted certain information concerning the KEIP including the Targets and the amounts to be paid to the KEIP Participants and the KERP Participants. Although the Debtor through the Motion discloses the names of the KEIP Participants and the KERP Participants, other than disclosing the titles of two of the four KEIP Participants, the Debtor does not disclose the titles of the KERP Participants, the titles of the remaining two KEIP Participants and the amounts of bonus going to each of the KEIP Participants and KERP Participants.

17. Although the Debtor, in the Motion, asserts that none of the KERP participants were insiders, as that term is defined in the Bankruptcy Code, the Debtor failed to provide sufficient information regarding the KERP participants to allow a determination as to the accuracy of that assertion.

ARGUMENT

A. The Governing Law: Section 503(c)

18. Section 503(c) of the Bankruptcy Code provides, in relevant part, that:

> 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 debtors' 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;

11 U.S.C. § 503(c).

19. As an initial matter, Section 503(c) must be applied to any contemplated transfer that is being made for the benefit of an insider of a debtor. Once it is determined that the individual who will receive the transfer is an insider, no transfer can be made where the transfer is being made for the purpose of inducing the person to remain with the debtor's business, unless the factors set forth in Sections 503(c)(1)(A) and (B) are met and either one of the mathematical formulas set forth in (C)(i) or (C)(ii) has been satisfied.

20. Congress added Section 503(c) in 2005 to curtail payments of retention incentives to insiders to "'eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process.'" *In re Residential Capital LLC*, 478 B.R. 154, 169 (Bankr. S.D.N.Y. 2012) ("Rescap") (*quoting In re Global Home Prods., LLC*, 369 B.R. 778, 784 (Bankr. D. Del. 2007); *accord In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 312-13 (Bankr. S.D.N.Y. 2012); *In re Velo Holdings, Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012).

21. In addition, Congress intended to limit the scope of key employee retention plans and other programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor. *Rescap*, 478 B.R. at 169. Congress intended to put into place "a set of challenging standards" for debtors to overcome before retention bonuses could be paid. *Global Home Prods.*, 369 B.R. at 784. The proponent of a bonus plan has the burden of showing that the plan is not a retention plan governed by Section 503(c)(1). *Hawker Beechcraft*, 479 B.R. at 313; *Rescap*, 478 B.R. at 170.

22. Where Section 503(c) applies, the transfer cannot be justified solely on the debtor's business judgment. *See In re Borders Group., Inc.*, 453 B.R. 459, 470-71 (Bankr. S.D.N.Y. 2011). If a proposed transfer falls within Section 503(c)(1), then the business judgment rule does

not apply, regardless of whether a sound business purpose may actually exist. *See In re Dana Corp.*, 351 B.R. 96, 101 (Bankr. S.D.N.Y. 2006) ("Dana I").

23. Further, a debtor's label of a plan as incentivizing to avoid the strictures of Section 503(c)(1) must be viewed with skepticism; rather, the circumstances under which the proposal is made and the structure of the compensation package control. *See Velo Holdings*, 472 B.R. at 209 ("Attempts to characterize what are essentially prohibited retention programs as 'incentive' programs in order to bypass the requirements of section 503(c)(1) are looked upon with disfavor, as the courts consider the circumstances under which particular proposals are made, along with the structure of the compensation packages"); *see also Hawker Beechcraft*, 479 B.R. at 313 ("The concern ... is that the debtor has dressed up a KERP to look like a KEIP in the hope that it will pass muster under the less demanding 'facts and circumstances' standard in ... §503(c)(3)."); *Dana I*, 351 B.R. at 102 n.3 ("If it walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP).").

24. Finally, not only must bonus plans comply with Section 503(c), but as administrative expenses they must also be "actual, necessary costs and expenses of preserving the estate," as required by Section 503(b). *See* 11 U.S.C. § 503(b); *In re Unidigital, Inc.*, 262 B.R. 283, 288 (Bankr. D. Del. 2001) (administrative expenses may not be allowed unless they are actual and necessary to preserve the estate); *In re Regensteiner Printing Co.*, 122 B.R. 323 (N.D. Ill. 1990) (reversing approval of severance agreements for key employees, because debtors presented no evidence that severance payments were necessary to preserve bankruptcy estate).

B. The Debtor Has Failed to Satisfy Its Evidentiary Burden to Demonstrate the KEIP is an Incentive Plan

25. The law is clear that the burden is on the Debtor to either show that the proposed bonus plan complies with the requirements of section 503(c)(1) or that it is not a disguised

retention plan. *See Dana I*, 351 B.R. at 100; *In re Mesa Air Group, Inc.*, No. 10-10018 (MG), 2010 WL 3810899 (Bankr. S.D.N.Y. Sept. 24, 2010), at *2 (*citing Global Home Prods.*, 369 B.R. at 785).

26. Retention plans usually are intended "to encourage certain crucial employees to remain with the company through a critical, transitional time period when the exact future of the company is unclear and when those employees would be most likely to search for other employment." *See In re The Brooklyn Hosp. Ctr. and Caledonian Health Ctr., Inc.*, 341 B.R. 405, 413 (Bankr. E.D.N.Y. 2006). Although the Debtor styles the KEIP as an incentive plan, the Debtor fails to satisfy the stringent criteria that it is not merely retentive. It is the substance of how and why the proposed payments are made, not the label put on the plan, that is determinative. *See Mesa Air Group, Inc.*, 2010 WL 3810899, at *4 (incentive plans are designed to motivate employees to achieve performance goals).

27. For a bonus plan to be incentivizing, it should be tied to significant goals that are difficult to achieve. *See e.g., In re Dana Corp., (Dana II)*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006), 358 B.R. at 583 (court approved long-term incentive plan where benchmarks were "difficult targets to reach and [were] clearly not 'layups'"); *Hawker Beechcraft*, 479 B.R. at 313-15 (court rejected proposed bonus plan where lowest levels of proposed metrics were "well within reach"); *Residential Capital, LLC*, 478 B.R. at 171-72 (court rejected proposed bonus plan where participants had to remain employed by debtors to receive payment, and there was a lack of challenging performance metrics).

28. In the present case, the only metric for determining payment of the KEIP is if the Targets are met, which are amounts undisclosed to the public. The Motion is presently unsupported to substantiate that achieving the Targets is a challenging and difficult to reach

objective for the KEIP Participants and the Debtor bears the burden of establishing that payment of substantial bonuses are not fait accompli. More evidence must be adduced to support the relief requested. Absent such showing, the Debtor has not satisfied the burden of demonstrating the bonus payments are not "primarily retentive."

29. As such, the KEIP appears to be a KERP and must comply with section 503(c)(1) of the Code. To comply with 503(c)(1), the Debtor must demonstrate three elements as to each "insider" who is to receive a bonus: (A) that they have a "bona fide job offer from another business at the same or greater rate of compensation;" (B) that "the services provided by the person are essential to the survival of the business;" and (C) that the amount to be paid to each insider is "not greater than an amount equal to 10 times the amount of the mean transfer of obligation of a similar kind given to nonmanagement employees." *See* 11 U.S.C. § 503(c)(1)(A),(B) & (C)(i). The Debtor has failed to provide sufficient evidence to meet this test.

C. The Debtor has Not Provided Sufficient Information Regarding the Participants in the KERP to Determine Whether any of them Qualify as Insiders Under the Bankruptcy Code.

30. Section 503(c)(1) applies to "insiders" of the Debtor who are eligible for bonuses. The Debtor asserts that none of the KERP participants are insiders, and provides only limited, generic information to overcome the presumption. Section 101(31) of the Bankruptcy Code defines an "insider" of a corporation as an "officer," a "director," or a "person in control." *See* 11 U.S.C. § 101(31). As stated in *In re Foothills Texas, Inc.*, 408 B.R. 573, 585 (Bankr. D. Del. 2009), "[a] person holding the title of an officer, including vice president, is presumptively what he or she appears to be—an officer and, thus, an insider." The Debtor therefore must either submit evidence to rebut the presumption or show that all participants in the KERP with officer

titles meet the requirements of 503(c)(1). Here, the Debtor set forth in the Motion the names of the individuals in the KERP but did not disclose their titles or the amounts they are to receive.

31. With respect to the managers and anyone else in the "range" between managers and vice-presidents, the Debtor also must establish through evidence that no such KERP participants are insiders.

D. The KEIP and KERP Are Not Justified By the Facts and Circumstances of This Case

32. If the Court finds that Section 503(c)(1) does not apply, the Court may also consider whether the payments are permissible under section 503(c)(3). *See Dana II*, 358 B.R. at 576. Section 503(c)(3) authorizes judicial discretion with respect to bonus plans motivated primarily by reasons other than retention. *See id.* Section 503(c)(3) limits payments made to the Debtor's employees outside of the ordinary course unless such payments are justified by "the facts and circumstances of the case." *See* 11 U.S.C. § 503(c)(3).

33. The payments here are not in the ordinary course of the Debtor's business. The Motion establishes that the Debtor more or less designed the KEIP specifically for the chapter 11 case and chose the KEIP Participants and KERP Participants in order to "maintain its business operations, improve and preserve its financial condition, facilitate its sales process and reorganization efforts, all while ultimately meeting its debtor-in-possession obligations and its debtor-in-possession duties during the pendency of the Debtor's Bankruptcy." *See* ECF No. 185 at page 10 of 21. In addition, "[t]he Employees covered by the KERP and the KEIP were identified after substantial, careful consideration and only after it was determined that each was critical to the maintenance of the Debtor's operations and the success of the Debtor's restructuring efforts." *See id.*

34. Transactions outside the ordinary course of business and that relate to compensation must be analyzed under 503(c)(3) though some courts have held that the "facts and circumstances" language of section 503(c)(3) creates a standard no different than the business judgment standard under section 363(b). *See Borders*, 453 B.R. at 473. The Debtor argues here that the business judgment standard applies to payments under section 503(c)(3). *See* ECF No. 185 at page 18 of 21.

35. The Debtor's assertion that the KEIP is governed by the business judgment rule ignores the pivotal holding of *Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.)*, 181 F.3d 527, 535 (3d Cir.1999), that the allowability of administrative expenses "depends upon the requesting party's ability to show that the fees were actually necessary to preserve the value of the estate. Therefore, we conclude that ***the business judgment rule should not be applied as such in the bankruptcy context***. Nonetheless, the considerations that underlie the debtor's judgment may be relevant to the Bankruptcy Court's determination." 181 F.3d at 535 (emphasis added). The proposed KEIP and KERP payments, like the break-up fees under consideration in *O'Brien Envtl. Energy, Inc.*, are administrative expenses and their allowance must be determined under administrative expense jurisprudence rather than the more lenient business judgment rule.

36. If the Court finds that the KEIP Payments do not fall within the parameters of section 503(c)(1) because they are not primarily retentive, then the Debtor must establish that the KEIP Payments are necessary to preserve the value of the estate and justified by "the facts and circumstances of the case." *See* 11 U.S.C. § 503(c)(3). The Debtor has the burden of proof to satisfy this standard and has failed to do so.

37. The U.S. Trustee leaves the Debtor to its burden of proof and reserves all discovery rights.

WHEREFORE, the United States Trustee requests that this Court deny the Motion with respect to the proposed KEIP unless it satisfies Section 503(c)(1), condition approval of the KERP on satisfactory evidence that no participant therein is an insider and grant such other relief as this Court deems appropriate, fair and just.

Respectfully submitted,

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By: */s/* Jeffrey M. Sponder
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Dated: November 6, 2021