Testimony Before the American Bankruptcy Institute Commission to Study the Reform of Chapter 11

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My name is Michael L. Bernstein. I am a partner in the law firm of Arnold & Porter LLP and chair of the firm's national bankruptcy and corporate restructuring practice.[1] I am a member of ABI's Board of Directors and a Fellow of the American College of Bankruptcy. For a number of years, I have had an interest in labor, benefits and related issues in bankruptcy. I have advised and represented debtors and other parties in connection with matters at the intersection of bankruptcy and labor and employment law, I have written and lectured on these subjects, and I have testified in Congress on several occasions concerning proposed bankruptcy reform legislation in the labor and benefits area. I previously served as co-chair of ABI's Labor and Employment Committee and I presently serve as co-chair of this Commission's Advisory Committee on Labor and Benefits.

I am grateful to the Commission for its effort to obtain a variety of views in addressing these important issues, and I appreciate the opportunity to present my perspective.

Some labor union representatives have argued that current law -- and the way it is being interpreted by the courts -- imposes a disproportionate burden upon a debtor's employees and retirees. To address this concern, they have sought numerous amendments to the Bankruptcy Code. While it is understandable that organized labor seeks legislative change to advance the interests of workers and retirees in corporate bankruptcies -- just as other stakeholders lobby to promote their own interests -- many of the modifications to existing law proposed in the legislation introduced by the Honorable John Conyers, Jr. -- *H.R. 100: The Protecting Employees and Retirees in Business Bankruptcies Act of 2013* -- would make chapter 11 reorganization more costly and more difficult to achieve. As a result, more debtors would fail

[1] The views expressed herein are solely my own, and do not necessarily represent the views of my firm or any of its clients. I am grateful to my colleague, Rosa J. Evergreen, for her assistance in preparing this submission.

and be forced into liquidation. This is inconsistent with the goals of chapter 11, and would be harmful to all stakeholders, including employees and retirees.

My testimony today focuses on certain key provisions in the proposed legislation -- which I have outlined below -- and some of the likely consequences if the bill were enacted. My testimony is not intended as a complete analysis of every provision of the bill, but is instead intended to highlight some of the (perhaps unintended) consequences the bill could have on the chapter 11 process.

A. Title 1: Improving Recoveries for Employees and Retirees.

1) *Sections 101-105 of the Bill Would Increase Administrative and Priority Claims and Thereby Impact a Debtor's Ability to Reorganize.*

Section 101 of the bill would amend § 507 to increase the wage priority.[2] Specifically, it would (i) amend § 507(a)(4) to increase the amount of the wage priority to $20,000, (ii) amend §§ 507(a)(4) and 507(a)(5) to eliminate the requirement that the claim be earned within 180 days of the bankruptcy filing (or the date of the cessation of business), and (iii) amend § 507(a)(5) to increase the amount of the employee benefit plan priority to $20,000 and to eliminate the provision that requires the claimant to subtract any amounts paid pursuant to § 507(a)(4).

Section 103 of the bill would add a new administrative expense for severance pay owed to employees of the debtor, under a plan, program or policy generally applicable to employees of the debtor, or pursuant to a collective bargaining agreement, for termination or layoff after the

[2] Section 507 of the Bankruptcy Code affords priority status to certain types of claims. It currently gives employees a priority wage claim up to $11,725. On April 1, 2013, the cap of $11,725 will increase to $12,475.

petition date.[3] This section of the bill would provide administrative priority for all severance that comes due post-petition, including the portion of a severance payment that is attributable to pre-petition service. This is at odds with most court decisions, which have allocated severance claims between the portion attributable to pre-petition service and the portion attributable to post-petition service. This "allocation" typically results in only a small portion of the claim being entitled to administrative expense priority.[4]

The modifications proposed in § 103 of the bill are inconsistent with the fundamental proposition that obligations attributable to a pre-petition time period (or "earned" pre-petition) are not entitled to administrative priority. It would also create an incentive for debtors to terminate employees prior to the bankruptcy filing, if there is a chance that they might have to terminate these employees at some point -- in order to avoid creating a large administrative severance obligation. Neither the debtor nor its employees benefit from a policy that encourages pre-petition termination of employees.

Section 105 of the bill would broaden the scope of administrative expense claims so that it would include WARN Act damages or back pay attributable to any period of time occurring after the commencement of the case, even if the layoff occurred pre-petition. It would thus reverse court decisions holding that § 503(b)(1)(A)(ii) does not afford administrative expense priority to WARN Act damages arising from a pre-bankruptcy termination. As with § 103 of the

[3] The administrative expense priority for severance pay would not apply to insiders, senior management, or consultants retained to provide services to the debtor, or to severance claims under individual employment contracts.

[4] There are some severance plans that provide for fixed-payment severance in lieu of notice, and under those plans a post-petition termination would give rise to an administrative expense for the full amount of the severance obligation -- because the severance is earned based solely upon the fact of termination, rather than based upon length of service. The proposed legislation would treat the more common "length of service" severance obligation the same way, rather than the way it has typically been treated by the courts, which is to allocate the obligation between the portion attributable to the pre-petition period and the portion attributable to the post-petition period.

bill, this would create an administrative expense for an obligation that is attributable to a pre-petition period.

Each of the provisions discussed above creates new or enlarges existing administrative expense and priority claims. While there are many types of claims that might be said to be "worthy" of priority treatment, creating new administrative expenses and priority claims makes reorganization more expensive and more difficult to achieve. It would be likely to result in more administrative insolvencies and more cases forced into liquidation. This impacts not only the debtor, but also other stakeholders, including employees and retirees, who suffer when a company is forced into liquidation. New administrative expenses and priority claims can also effectively subordinate other claims where there is not sufficient value to pay all creditors in full. Thus, higher recoveries for employees may mean lower (or no) recoveries for trade creditors, tort victims, customers, taxing authorities, and other creditors.

B. <u>Title II: Reducing Employees' and Retiree' Losses</u>.

1) *Section 201 of the Bill Would Unduly Limit a Debtor's Ability to Modify Collective Bargaining Agreements.*

   a. *The bill would amend § 1113 to change the standard from "necessary to permit reorganization" to "shall be not more than the minimum savings essential to permit the debtor to exit bankruptcy, such that confirmation of a plan of reorganization is not likely to be followed by the liquidation, or need for further financial reorganization of the debtor [] in the short-term."*

Section 1113 of the Bankruptcy Code sets forth the requirements for a debtor to reject a collective bargaining agreement. Unlike other contracts, which can be rejected by a debtor if doing so is found to be a reasonable exercise of the debtor's business judgment, rejection of a collective bargaining agreement is evaluated using a considerably more stringent standard.

The modified requirements in § 201 of the bill would make it even more difficult for a debtor to modify or reject a collective bargaining agreement. Under the proposed standard, some

companies that need to modify their labor costs in order to successfully reorganize will be unable to do so. Other companies will be able to get "the bare minimum" relief to enable them to emerge from bankruptcy but, because of the absence of an adequate "margin of error," and the inevitable performance variations, business cycles and unforeseen events that every company faces, will end up having to liquidate after emergence or file second chapter 11 cases. This is inconsistent with the goal of § 1113, and of chapter 11 more generally, which is to enable companies to emerge as viable and competitive enterprises.

Moreover, new investment capital is typically required for a company to emerge from chapter 11. The investors upon which chapter 11 debtors (and their creditors and other stakeholders) rely have many opportunities to deploy their capital. Recognizing that there will inevitably be, after emergence, some "bumps in the road," investors are unlikely to infuse capital into a company that has achieved a cost structure that is barely adequate to emerge from chapter 11 and survive in the short-term. Investors want a company that emerges with a cost structure that will enable it to be viable and competitive for the foreseeable future. In this sense, the standard suggested by the proposed legislation is unrealistic -- it ignores what is required, in the real world, in order for a company to emerge from chapter 11.

b. *The bill would require any § 1113 proposal to be "proposed only as part of a program of workforce and nonworkforce cost savings devised for the reorganization of the debtor, including savings in management personnel costs;" and creates a presumption that where a "bonus" plan was implemented "for insiders, senior executive officers, or the 20 next most highly compensated employees" during case or 180 days before commencement, the debtor fails to meet the test regarding § 1113.*

These provisions conflate two separate issues. A debtor should, to the best of its ability, pay market-competitive wages and benefits to all types of employees -- including senior management, mid-level management, salaried employees and hourly employees, whether represented or not. If a company fails to pay market-competitive wages and benefits, it risks

losing the best of its workforce. Thus, while a debtor should not "over-pay" management employees, it should provide those employees with compensation, including bonus compensation, at a level that is reasonably necessary to attract, retain and incentivize a capable management team. Similarly, a company should, to the extent of its ability, provide market-competitive wages and benefits to represented employees.

There are cases where a debtor is paying market-competitive (or below-market) wages to management employees but is paying above-market or otherwise unsustainable compensation and benefits to represented employees. In those cases, the debtor must maintain (or potentially even increase) management compensation and/or provide incentive compensation, while seeking relief from its represented employee labor costs. This will not be the situation in every case -- or even in most cases -- but there are certainly some cases in which it is true. The Bankruptcy Code should not create a "Catch 22" for debtors -- requiring that they choose between paying market-competitive compensation to management or achieving an overall competitive labor cost structure. But that is precisely what these provisions would do, by tying management and hourly compensation to one another, in a way that is not reflective of the marketplace in which the chapter 11 debtor must compete. It would force at least some debtors to either (i) risk losing their most talented managers (perhaps to a competitor -- it is common for a company to use its competitor's bankruptcy as an opportunity to cherry-pick the debtor's best talent); or (ii) be unable to reorganize because it cannot achieve a competitive labor cost structure. Investors are also less likely to invest in a business that is precluded from compensating and incentivizing its management team at market-competitive levels or that is unable to achieve an overall labor cost structure that enables it to be viable. In this way, these proposed provisions would impair companies' ability to reorganize in, and successfully emerge from, chapter 11.

c. *The bill would amend § 1113(d) to slow down the § 1113 process and add additional procedural requirements.*

The bill would amend § 1113(d) to slow down the § 1113 process by, among other things, deleting the requirement in § 1113(d)(2) that provides that the court shall rule on a rejection application within thirty days. It would also delay a debtor's ability to file a rejection application until the parties "have not reached an agreement over mutually satisfactory modifications, and further negotiations are not likely to produce mutually satisfactory modifications." These provisions are problematic for a number of reasons. Labor costs are often a gating item in a chapter 11 reorganization. Other essential elements, including (but not limited to) obtaining exit financing and other new investment capital, typically require knowing the company's post-emergence cost structure, of which labor costs is typically an important element. Slowing down the § 1113 process is thus likely to delay the chapter 11 reorganization process. This is not in any constituency's interest. Delay is likely to make the chapter 11 process more expensive and more risky. Moreover, the pendency of an § 1113 application, with an upcoming hearing date, has often been the catalyst for an agreement between the debtor and its union. Thus, delaying the § 1113 proceeding is likely to delay any agreement.

BAPCPA contained various amendments aimed at accelerating the chapter 11 process; this amendment would be inconsistent with Congress' goal to speed up the bankruptcy reorganization process. If anything, keeping in mind the substantial costs and risks associated with delay, the § 1113 process should be accelerated, not drawn out.

d. *The bill would prohibit creditors and other interested parties from participating in the § 1113 hearing.*

Even though their recoveries could be substantially affected by the outcome, the bill would prohibit creditors and other interested parties from participating in a § 1113 hearing.[5] The court already has the authority to streamline hearings, to achieve efficiency and avoid repetition. But there is no valid reason to deny interested parties, such as a creditors committee, their right to be heard on such important issues in the chapter 11 case, and doing so would be inconsistent with § 1109(b) of the Code, which allows any party in interest to be heard on issues in a chapter 11 case.

e. *The bill would require the court to find that implementation of the debtor's proposal to modify wages, benefits and work rules "shall not cause a material diminution in the purchasing power of the employees covered by the agreement."*

Depending upon how this provision is interpreted, it could make § 1113 relief nearly impossible to obtain. It is almost always the case that § 1113 relief will impact the affected employees' purchasing power. Provisions such as this one -- which make it more difficult or impossible to reduce labor costs, regardless of the necessity of doing so, are likely to result in fewer successful reorganizations.

Of course, if a debtor that needs labor cost relief does not obtain that relief, and is therefore forced to liquidate and/or to lay off employees, the employees' purchasing power will also be diminished, and to a much greater extent than if their wages and benefits are reduced to a sustainable, market-competitive level.

Moreover, tilting the balance of leverage in § 1113 disputes so far in favor of labor will reduce the number of consensual resolutions, because the union will have less incentive to

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[5] This would be accomplished by inserting language in § 1113(d) that provides "[o]nly the debtor and the labor organization may appear and be heard at such hearing."

negotiate. Under present law, there is a balance of power which results, in the overwhelming majority of cases, in negotiated rather than litigated resolutions. Consensual resolutions tend to be faster and less costly, and leave less animosity post-emergence.

f. *The bill would prevent the court from approving rejection of a collective bargaining agreement "that would result in modifications to a level lower than the level proposed by the trustee in the proposal found by the court to have complied with the requirements of this section."*

It is not uncommon for a debtor, in § 1113 litigation, to agree that if it is granted relief it will implement the terms proposed in its most recent offer. However, requiring the debtor to do this in every case is likely to reduce the number of consensual resolutions -- which is at odds with the objective of § 1113.

If the union's "worst case scenario" were the debtor's highest settlement offer, the union could feel free to reject every settlement proposal and litigate without risk. There would be no downside.[6] This is no more likely to foster consensual resolutions in the § 1113 context than it would in any other context. Any credible mediator will tell you that an important motivating factor in achieving settlement is that each side has litigation risk and potential downside. If you take away that risk, you eliminate a powerful motivator toward settlement. Under existing law, both sides have litigation risk, and most situations are resolved through negotiation. That should not change.

[6] This is particularly true because, as discussed below, the proposed legislation would also require the estate to pay the union's professional fees. Thus, the union would litigate not only without risk, but also without cost. The cost of litigation is another motivator for parties to attempt to reach settlements.

g. *The bill would add a new section allowing the union, at any time, to "apply to the court for an order seeking an increase in the level of wages or benefits, or relief from working conditions, based upon changed circumstances."*

Chapter 11 debtors need finality on the issue of labor costs so that they can do the other things necessary to reorganize and emerge from bankruptcy, such as reach agreements with creditor constituencies, line up exit financing, prepare cash flow forecasts, formulate a business plan, and determine the feasibility of their chapter 11 plan. A debtor typically cannot do these things until there is finality with respect to its cost structure. In particular, a provision that would allow the union, at any time after a § 1113 decision or agreement, to re-litigate the issues that were settled or decided, would make raising committed new investment capital, in cases in which labor costs are a material factor, nearly impossible, and would make successful reorganizations materially more difficult.

h. *The bill would authorize "self help" by labor representatives if the court grants § 1113 relief.*

Self-help (*i.e.*, strikes or similar job actions in retaliation for § 1113 relief) can torpedo a company's reorganization efforts. If that happens, the purpose of § 1113 (and of chapter 11 more generally) will be undermined, and the company and its stakeholders will suffer. If the goal is to enable companies to emerge from chapter 11 with a viable business and a competitive cost structure -- and to be able to attract new capital which is often critical to successful emergence -- then a bankruptcy court should not be precluded from enjoining action taken in retaliation for § 1113 relief, where such an injunction is necessary to achieve the objectives of chapter 11. Such injunctions should not be issued lightly. In order to obtain such an injunction, a debtor should have a burden to demonstrate that the retaliatory job action is likely to impair its ability to reorganize, and any such injunction should be narrowly tailored to achieve its purpose.

i. *The bill would require the debtor to pay the unions reasonable professional fees and expenses in connection with any § 1113 matter.*

Adding a category of professional fees that the estate must bear makes an already expensive process even more costly, to the detriment of creditors and other stakeholders. Thus, it should not be done lightly. But the problem with this provision goes beyond the costs to the estate. A more significant problem is that the provision would diminish the union's incentive to negotiate -- because it can litigate for free. Allowing the union to litigate without bearing the costs of doing so (and, as proposed in modified § 1113(d)(4) of the bill, without risk) will promote litigation rather than negotiated resolutions. This is not good policy. The goal of § 1113 is to encourage negotiated resolutions. Companies that are able to resolve their labor issues consensually are, generally speaking, more attractive targets for new investment and more likely to be able to successfully reorganize. They are also more likely to have amicable labor relations post-emergence. The current system, under which the company must pay its legal and other professional fees, and the union must pay its own fees, creates an incentive for each side to fully explore settlement before deciding to litigate.

2) *Section 202 of the Bill Would Unduly Restrict a Debtor's Ability to Modify Retiree Benefits.*

Most of the proposed modifications to § 1114 track the modifications to § 1113. As a result, the proposed modifications to this section would create many of the same impediments to reorganization that I have discussed above with regard to § 1113.

The bill would also amend § 1114(a), which defines the term "retiree benefits," to provide that the term applies "whether or not the debtor asserts a right to unilaterally modify such payments under such plan, fund, or program." The apparent purpose of this language is to overrule cases holding that if a debtor or trustee has a valid contractual right under non-bankruptcy law to modify or terminate retiree benefits, the provisions of § 1114 do not override

that right. To the extent that the bill would afford retiree benefits under § 1114 beyond the debtor's contractual obligation to provide such benefits, it seems inappropriate. Retirees should not have better rights (and, correspondingly, companies should not have greater obligations) in chapter 11 than they would outside of chapter 11.

3) *Section 203 of the Bill Would Amend § 363 to Require a Court Consider, in Deciding Whether to Approve a Sale, Whether "a Bidder Has Offered to Maintain Existing Jobs, Preserve Terms and Conditions of Employment, and Assume or Match Pension and Retiree Health Benefit Obligations."*

I believe that, when there are competing offers to purchase assets, a bankruptcy court should have the discretion to consider, as one factor, the extent to which a buyer has agreed to preserve jobs and benefits -- although I think this factor should have less weight where the assets being sold are subject to a valid lien held by an undersecured creditor, since that creditor's "bargain" to receive the full value of its collateral should be respected, in order not to discourage secured lending.

However, if this provision would preclude a court from approving a sale unless the buyer commits to maintain existing jobs and preserve all pensions and retiree benefits, that is not realistic. The reality is that in many cases there is no buyer who is willing to preserve all of the debtor's employees' jobs and assume all of its pension and retiree liabilities. The law should be clear that asset sales that do not result in full job, pension and retiree benefit preservation may still be approved where they are the only alternative, or where, taking all factors into account, they are the highest and best available alternative.

4) *Section 204 of the Bill Would Amend § 502 of the Bankruptcy Code to Allow a Claim by a Participant in a Defined Contribution Plan for the Loss in Value of Stock in the Plan.*

This provision, along with a corresponding provision in § 102 of the bill,[7] would create an allowed claim for lost value of stock in a defined contribution claim, arising from fraud or breach of duty. It would elevate effectively an equity interest to the status of debt. This provision would create a disparity between the beneficiaries of a defined contribution plan and other similarly situated shareholders, who also purchased stock that subsequently lost value. If a claim for loss stock is allowable and not subordinated, it would seem to make sense for all shareholders who lost stock value -- or in the case of this bill, all shareholders who lost stock value as a result of fraud or breach of duty by the company to the shareholder -- to be treated in parity, rather than employee shareholders being treated preferentially to non-employee shareholders. Of course, this would diminish the recovery of unsecured creditors, and would be at odds with § 510(b) of the Bankruptcy Code.

5) *Section 205 of the Bill Would Amend § 506(c) to Treat Wages, Vacation, Severance, and Other Benefits Owed Post-Petition Pursuant to Policies and Practices of the Debtor, or a CBA, as Expenses that Can Be Subject to Surcharge of a Secured Creditor's Collateral, Notwithstanding the Waiver of a Surcharge Right.*

In most cases, secured lenders consent to the use of their cash collateral to pay ordinary course employee wage and benefit expenses. However, making a "forced" surcharge could decrease the availability, and increase the cost, of secured credit. It is not prudent to enact legislation that impedes the ability of a debtor to obtain financing. And because secured lenders typically allow their collateral to be used for these purposes, the modification is not necessary.

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[7] Section 102 of the bill would amend § 101(5) of the Bankruptcy Code, which defines a "claim," to include a claim for diminution in value of equity securities in a defined contribution plan for employees (except for insiders, senior executive officers or top 20 most highly compensated employees), where the employer or plan sponsor who commenced bankruptcy has committed fraud with respect to the plan or otherwise breached a duty to the participant that proximately caused the loss of value.

5) *Section 206 of the Bill Would Amend § 1129(c) to Require that When Competing Chapter 11 Plans are Proposed, the Court Must Confirm the Plan that "Would Preserve Going Concern Value Through the Productive Use of the Debtor's Assets and Preservation of Jobs" and Create a Presumption that a Plan that Incorporates the Terms of a Settlement with a Labor Organization Representing Employees Constitutes the Plan that Satisfies § 1129(c).*

Section 206 would essentially require that, when deciding between competing plans, the court must confirm the plan that is preferred by, or incorporates a settlement with, a labor union.[8] I agree that, in deciding between competing plans, each of which satisfies the other requirements for plan confirmation, a court should take into account the interests of employees and retirees. However, this provision appears to do more than require a court to take into account employees' and retirees' interests -- it appears to require the court to consider those interests *to the exclusion of* other interests, such as those of trade creditors, bondholders, lenders, tort victims, taxing authorities, and customers. Elevating one interest over and above others is inconsistent with the need to balance competing interests that is at the heart of the chapter 11 process.[9]

6) *Section 207 of the Bill Would Modify § 1121 to Provide that a Debtor's Filing a § 1113 Application Will Constitute Cause for Termination of Exclusivity if an Alternative Plan Proposed or Agreed-to by a Labor Union Could be Confirmed.*

Section 207 would modify § 1121 of the Bankruptcy Code to provide that a debtor's seeking relief under § 1113 will constitute cause for termination of the periods during which the debtor has the exclusive right to propose and solicit acceptances of a plan if an alternative plan (either proposed by the labor union or by another plan proponent if it incorporates the terms of a

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[8] There is a potential for ambiguity because it is possible that each competing plan might incorporate a settlement with a different labor union, and in that event it would be unclear, under the proposed statutory language, which plan the court must confirm.

[9] This provision also appears to require the court, in all cases, to confirm a reorganization plan over a competing liquidating plan. While ordinarily reorganization is preferable to liquidation, there are some cases in which liquidation will generate greater value -- and in those cases the court should not be precluded from confirming a liquidating plan.

settlement with the labor union) is reasonably likely to be confirmed. This appears to be intended to create a disincentive for companies to seek § 1113 relief. It could cause some companies that legitimately need § 1113 relief in order to emerge from bankruptcy as viable and competitive enterprises not to seek such relief, by threatening them with a loss of exclusivity.[10]

Termination of exclusivity can cause chaos, materially increase costs, delay the case, and diminish the prospects for a successful reorganization. It does not seem consistent with the reorganization goals of chapter 11 for a debtor to be threatened with a loss of exclusivity simply because it exercises its statutory right to seek relief under § 1113.[11] The provision could also impair access to new investment capital, because investors typically look for a business that can emerge with a competitive cost structure and also ordinarily prefer situations where exclusivity is in effect. Under this proposal, one or the other of those two things may be impossible.

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[10] The "reasonably likely to be confirmed" standard could also lead to substantial, time-consuming and expensive litigation.

[11] Under existing law, a labor union is free to seek termination of exclusivity if it believes there is "cause" for doing so and has an alternative plan to offer. I would not propose to change that. But that is obviously very different than saying that the filing of an § 1113 application shall constitute cause to terminate exclusivity.

C. Title III: Restricting Executive Compensation Programs.

1) *Sections 301-304 of the Bill Would Limit a Debtor's Ability to Retain Management Employees During a Chapter 11 Proceeding and to Determine Appropriate Management Compensation After Bankruptcy.*

    a. *Section 301 of the bill would amend § 1129(a)(4) and § 1129(a)(5) to restrict a debtors ability to provide compensation -- including post-emergence compensation -- under a plan.*

First, § 301 of the bill would, through an amendment to § 1129(a)(4),[12] require that payments made to insiders, senior executive officers, or any of the "20 next most highly compensated employees or consultants providing services to the debtors," could be approved only "as part of a program of payments or distributions generally applicable to employees of the debtor, and only to the extent that the court determines that such payments are not excessive or disproportionate compared to distributions to the debtor's nonmanagement workforce."

I agree that it is appropriate to ensure that payments made under § 1129(a)(4) are not excessive. Indeed, courts exercise this authority under existing law. However, the standard should be whether the services rendered were necessary, the extent to which the debtor and its estate received value from such services, and the market rate for such services, rather than creating an artificial linkage to other employees' compensation.

Section 301 of the bill also would, through an amendment to § 1129(a)(5),[13] require the bankruptcy court (i) to approve the compensation to be paid to insiders of the debtor ***after*** emergence from bankruptcy, and (ii) to find the post-emergence compensation to be "reasonable

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[12] Section 1129(a)(4) sets forth the requirements that payment, made or promised by the debtor or person issuing securities or acquiring property under the plan, for services in connection with the bankruptcy case or plan, be disclosed and approved by the court.

[13] Section 1129(a)(5) requires that, in order for a court to confirm a plan of reorganization "the proponent of the plan has disclosed the identity of an insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider." 11 U.S.C. § 1129(a)(5)(B). Under current law, the debtor is required to disclose compensation to insiders, but court approval of such post-bankruptcy compensation is not required.

when compared to persons holding comparable positions at comparable companies in the same industry and not disproportionate in light of economic concessions by the debtor's non-management workforce during the case."

Requiring bankruptcy courts to approve post-bankruptcy compensation plans for senior managers is inconsistent with the notion that, once reorganized, a debtor should make its own business decisions and freely compete in the marketplace. Typically the court's supervision of a debtor ends after its plan becomes effective (other than limited post-confirmation proceedings, intended to wrap-up the bankruptcy case, such as claim objections). Bankruptcy courts should not be in the business of approving or disapproving a debtor's compensation plans -- or other business decisions made by the company -- after the debtor emerges from bankruptcy.

b. *Section 302 of the bill would limit management compensation.*

This section would add a provision to § 503(c)(1) extending that section's restriction on retention bonus compensation, which presently applies only to insiders of the debtor, to any "senior executive officer, or any of the 20 next most highly compensated employees or consultants." It would also extend the requirements imposed by BAPCPA in § 503(c)(1), which now apply only to "retention bonuses," to all bonuses, all incentive or performance compensation, and any "financial returns designed to replace or enhance incentive, stock, or other compensation . . . ", essentially making it impossible to make any such payments. This section would also heighten the standard under § 503(c)(3) to make it more difficult for a debtor to pay incentive or similar compensation to any other management employees (including non-insiders) or consultants.

Incentive compensation is often necessary in order to retain and motivate a talented management team. This is especially true given the risks of working for a chapter 11 debtor and the efforts sometimes made by competitors to cherry-pick the debtor's best management talent.

In order for a debtor to successfully emerge, it typically needs a stable, capable, properly incentivized management team.

The reference to the "20 next most highly compensated employees" is also arbitrary. While the focus of discussion is often on the most senior officers of a company, in some companies the "top 20" includes mid-level salaried employees. In other companies, union-represented employees may be among the "top 20." The proposed limitations are thus arbitrary and overbroad.

No chapter 11 debtor should be paying any employee -- officers, mid-level managers or anyone else -- unnecessary bonus compensation. Companies have an obligation to their stakeholders not to provide excessive compensation. Under current law, courts have the authority to disallow excessive compensation, and debtors are "policed" by the courts, creditors' committees, the United States Trustees, and other constituents who have been active in raising issues when they believe that proposed bonus or other compensation is excessive.

I believe legislation that would prohibit or arbitrarily limit incentive compensation would be a mistake. The cost of such compensation is rarely (if ever) material, from the estate's perspective -- but it can be critical to preserve stability and to properly incentivize a debtor's leadership. Debtors need the ability, on a case-by-case basis, and subject to court oversight, to determine the appropriate market-competitive compensation, including bonus and incentive compensation, to pay their managers and consultants. Without the flexibility to pay market-competitive compensation (including incentive bonuses), a debtor's ability to compete for talent will be impaired. A prohibition on incentive compensation is not consistent with the goal of promoting successful reorganizations.

c. Section 303 of the bill would link the assumption of deferred compensation plans to the termination of defined benefit plans and §§ 1113 or1114 relief.

Section 303 of the bill would amend Bankruptcy Code § 365 to preclude a debtor from assuming a deferred compensation plan for the benefit of insiders, senior officers or any of the "20 next most highly compensated employees" of the debtor, if the debtor has terminated its defined benefit plan during or within 180 days prior to the bankruptcy filing or has obtained §§ 1113 or 1114 relief.

These issues should be considered separately, and not conflated. A debtor should assume a deferred compensation plan only if doing so is a reasonable exercise of its business judgment. If challenged, the debtor will have to put on evidence to show this. If there is not a good basis for the assumption, the court should -- and under current law can -- deny the request. However, the issue of whether the debtor has terminated a defined benefit plan or has sought relief under §§ 1113 or 1114 of the Bankruptcy Code is irrelevant to this question, and linking the two serves no legitimate purpose. At most, there is a symbolic nexus between the issues. But the law should not be premised on symbolism, but instead on what a debtor needs to do in order to maximize the value of its business and assets for the benefit of its stakeholders.

d. Section 304 of the bill would link a cause of action for recovery of executive compensation to §§ 1113 or 1114 relief.

The bill would add a new § 563 to the Bankruptcy Code -- to create a cause of action for the return of personal compensation paid to certain officers and directors if the debtor obtains §§ 1113 or 1114 relief. This provision would put officers and directors in a "Catch 22" position -- they can either decline to implement labor cost reductions that are necessary for their company to reorganize, or they can implement such reductions but thereby expose themselves to a lawsuit to disgorge their own compensation. Officers and directors should not be penalized for exercising their fiduciary duty to evaluate their company's labor cost structure and, where

necessary, seeking modifications. As with several other provisions in the bill, this provision would likely impact the ability of a troubled company (particularly one with labor cost issues) to retain and attract officers and directors and/or to achieve a competitive labor cost structure.

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In enacting chapter 11, Congress observed that, "[i]t is more economically efficient to reorganize than liquidate, because it preserves jobs and assets." H.R. Rep. 95-595, 95th Cong., 1st Sess. 220 (1977). In the 35 years since chapter 11 was enacted, this has proven to be true -- many companies have reorganized in chapter 11, preserved assets and going concern values, and gone on to become viable companies, serving customers, buying from suppliers, paying taxes, contributing to local communities, and employing workers. But, as we have seen from the failures, chapter 11 reorganization is not easy. It requires a talented and properly-motivated management team to lead the effort. It requires paying attention to the competitive landscape. It often requires convincing new investors, who have many investment opportunities, to invest in the reorganization. It requires a difficult balancing of competing interests. And it requires sacrifice, often including painful cost-cutting measures.

The proposed legislation is likely to have the unintended consequence of making reorganization more difficult to achieve. It would result in more litigation, higher reorganization costs, fewer investors willing to commit capital, more difficulty in retaining capable management, and less ability to achieve the competitive cost structure that is necessary for a company to survive and prosper after emergence. It would result in fewer successful reorganizations, more companies liquidating, and diminished recovery for creditors.

The interests of workers in chapter 11 are worthy of attention. Workers have an important stake in the success of their companies, and they make a major contribution to that

success. They should be treated fairly and should not bear a disproportionate burden. However, this legislation is, in my view, not an optimal way to address these issues. Its consequences would be damaging to all stakeholders, including employees.