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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	)	Chapter 11
FRONTIER COMMUNICATIONS CORPORATION, *et al.*,[1]	)	Case No. 20-22476 (RDD)
Debtors.	)	(Jointly Administered)

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTORS' MOTION FOR ENTRY OF AN ORDER (I) APPROVING DEBTORS' PERFORMANCE-BASED INCENTIVE PROGRAMS FOR INSIDER AND NON-INSIDER PARTICIPANTS AND (II) AUTHORIZING THE DEBTORS TO PAY CERTAIN RESTRICTED CASH AWARDS TO NON-INSIDER PARTICIPANTS [DKT. NO. 498]

[1] The last four digits of Debtor Frontier Communications Corporation's tax identification number are 9596. Due to the large number of debtor entities in these chapter 11 cases, which are jointly administered, a complete list of the debtor entities and the last four digits of their federal tax identification numbers are not provided herein. A complete list of such information may be obtained on the website of the Debtors' proposed claims and noticing agent at https://cases.primeclerk.com/ftr. The location of the Debtors' service address for purposes of these chapter 11 cases is: 50 Main Street, Suite 1000, White Plains, New York 10606.

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The Official Committee of Unsecured Creditors (the "**Committee**") of Frontier Communications Corporation and its affiliated debtors and debtors in possession (collectively, the "**Debtors**"), by and through its undersigned counsel, hereby submits this objection (the "**Objection**") to the *Debtors' Motion for Entry of an Order (I) Approving the Debtors' Performance-Based Incentive Programs for Insider and Non-Insider Participants and (II) Authorizing the Debtors to Pay Certain Restricted Cash Awards to Non-Insider Participants* [Dkt. No. 498] (the "**PBIP Motion**").[2] In support of the Objection, the Committee respectfully states as follows:

PRELIMINARY STATEMENT

1. Four months ago, with a potential bankruptcy looming on the horizon, the Debtors paid substantial retention bonuses to their insider executive employees. These insiders received the entirety of their 2020 retention bonuses, which indisputably would not have been permitted after the Debtors filed a petition for chapter 11 relief, in advance of the bankruptcy filing.[3] Now, the Debtors seek to further enrich their executive employees, as well as a group of upper management employees who also received pre-paid retention bonuses, through a purported incentive program linked to certain performance metrics. Particularly in light of the already-paid (and unusually large) retention bonuses, the proposed incentive payments are above market, and the structure of those payments is not adequately designed to achieve the Debtors' goal of motivating performance.

2. Specifically, the Debtors seek to implement two purportedly performance-based incentive programs with a total potential cost of $25.2 million, PBIP Motion, ¶ 21: one program for eight of their insider executive employees (the "**Insider PBIP**") and another for 44 of their

[2] Capitalized terms used but not defined herein have the meanings ascribed to them in the PBIP Motion.
[3] In contrast, participants in the previously approved KERP will receive their 2020 retention payments quarterly.

upper management employees (the "**Non-Insider PBIP**"). Participants are eligible for payments under the programs if the Debtors achieve certain performance metrics – adjusted EBITDA, revenue, and net broadband adds. The Committee has no objection to the Debtors making incentive payments to their insider and management employees to achieve the Debtors' goal of encouraging their employees "to achieve value-driving financial targets" and to "motivate and reward" participants for "increased demands placed upon them in connection with the chapter 11 process." PBIP Motion, ¶ 46. However, the proposed Insider PBIP and Non-Insider PBIP are not adequately designed to achieve these goals. The programs are primarily retentive rather than incentivizing, since the performance goals are too easily attained. Moreover, the cost of the PBIPs is unreasonable because, compared to compensation granted by the Debtors' peer companies, per person compensation is excessive, particularly when pre-petition retention payments are included in the comparison. And the timing of the programs is not reasonably designed to motivate employees to achieve the Debtors' financial goals throughout the bankruptcy cases, because the Insider PBIP and Non-Insider PBIP terminate at the end of 2020, likely well before the Debtors' emergence from bankruptcy.

3. The Committee files this Objection only after working diligently to evaluate the proposed Insider PBIP and Non-Insider PBIP, and to try to reach a consensual resolution with the Debtors. The Committee and its advisors requested key information from the Debtors and proposed modifications similar to those outlined in this Objection. To date, however, the Committee and the Debtors have not reached a consensus on the appropriate size of, thresholds for, and timing of the Insider PBIP and Non-Insider PBIP payments.

BACKGROUND

I. General Background

4. On April 14, 2020 (the "**Petition Date**"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. These cases are being jointly administered (the "**Chapter 11 Cases**") [Dkt. No. 78].

5. On April 23, 2020, the United States Trustee for Region 2 appointed the Committee [Dkt. No. 142]. The Committee consists of the following seven members: (i) AT&T Services, Inc.; (ii) The Bank of New York Mellon; (iii) Cathy Bailey; (iv) Eversource Energy; (v) Pension Benefit Guaranty Corporation; (vi) Communication Workers of America, AFL-CIO, CLC; and (vii) U.S. Bank National Association.

II. The Debtors' Prepetition Incentive and Retention Programs

6. In February 2020, the Debtors' Compensation Committee approved the terms of the Debtors' executive compensation program for fiscal year 2020. 8-K, Feb. 26. 2020. The approved compensation program included "base salary, cash retention awards, performance awards and quarterly bonus plan awards on terms and in amounts substantially consistent with the 2019 executive compensation program." *Id.* The compensation program for the Insider PBIP participants included cash retention awards, paid in February 2020 (described in more detail below), quarterly performance incentive cash awards ("**Performance LTI**"), and quarterly short-term bonus performance-based awards payable in cash ("**Annual Incentives**"). *Id.* The prepetition compensation program for the Non-Insider PBIP participants included the Annual Incentives, cash retention awards paid in October and November 2019, and Restricted Cash Awards ("**RCAs**") (described in more detail below). Declaration of Zachary P. Georgeson (the "**Georgeson Declaration**") [Dkt. No. 500], ¶¶ 19, 38; Wages Motion [Dkt. No. 26], ¶ 39.

7. Both the Non-Insider PBIP and Insider PBIP participants received significant prepetition retention payments. With bankruptcy on the horizon, and knowing that courts are reluctant to approve retention payments to insiders during a bankruptcy case, the Insider PBIP participants were paid "the retention-based component of the[ir] 2020 compensation," [redacted] in the aggregate, in February 2020. PBIP Motion, ¶ 4, n.3. These retention payments are subject to recapture until the earlier of February 28, 2021, and the Debtors' emergence from chapter 11. *Id.* Likewise, the Non-Insider PBIP participants were paid [redacted] in aggregate retention payments in October and November 2019, subject to recapture until April 15, 2021. *Id.* In contrast, retention payments for the Debtors' non-insider employees were not pre-paid, and were approved through the KERP Motion (described below).

8. In addition to the prepetition retention payments, the Debtors historically provided a retention-based incentive program for non-executive employees, payable in stock grants which vested over a three-year period. In recent years, the Debtors made two major modifications to their RCA program. First, in 2017, the Debtors replaced the stock grants with cash grants, with payouts divided equally over a three-year period. Second, a little more than seven months ago, with a potential bankruptcy filing on the horizon, the Debtors again modified the RCA program to compress the cash payments previously made over three years into quarterly payments made over just one year, without a corresponding reduction in amount. Wages Motion [Dkt. No. 26], ¶ 42 (describing retention plan after October 2019 modifications). The Committee understands that the revised program did not reduce the amount awarded under the retention program; instead, employees would now receive during the course of one year the amount they would previously have received over three years.

9. The Committee understands that in February 2020, the Non-Insider PBIP participants received their first RCA payment under the 2019 RCA program, and their second payment under the 2018 RCA program.

III. The KERP Motion

10. On May 5, 2020 the Debtors filed the KERP Motion, which sought approval of a key employee retention plan (the "**KERP**"). [Dkt. No. 227]. The KERP applies to 390 non-insider employee participants, and has two main components: (1) Annual Awards that are performance-based, and (2) Retention Grants that are non-performance-based. Both the Annual Awards and the Retention Grants are payable quarterly. KERP Motion [Dkt. No. 227], ¶¶ 4, 18. The Debtors sought authority to pay up to $21.01 million in Annual Awards and $14.685 million in Retention Grants, with a $2 million reserve pool, for a total program cost of $37.7 million. KERP Motion, ¶ 4. The Annual Awards payable under the KERP vary in amount based on whether certain metrics are satisfied, whereas the "Retention Grants will be fixed cash amounts independent of performance metrics." KERP Motion, ¶ 19. The metrics applicable to the Annual Awards under the KERP are (i) revenue, (ii) adjusted EBITDA, and (iii) net broadband adds. The Debtors also sought authorization to continue their RCA program for the KERP participants, with the next payments to be made in February 2021 and February 2022. KERP Order [Dkt. No. 383], ¶ 1.

11. The Committee objected to the KERP Motion, arguing that the KERP was not sufficiently retentive due to the structure of the Retention Grants. [Dkt. No. 292]. The Committee suggested deferring two-thirds of the payments due on account of the Retention Grants to the Debtors' emergence from Chapter 11. After filing its objection, the Committee continued to negotiate with the Debtors and the two Ad Hoc Unsecured Noteholder Groups, and reached a settlement on the KERP Motion, whereby one-third of the payments due on account of the Retention Grants would be paid upon emergence.

12. The Court entered the *Order Approving the Debtors' Key Employee Retention Plan* [Dkt. No. 383] (the "**KERP Order**"), which approved the Debtors' key employee retention program (the "**KERP**"), as modified in agreement with the Committee and the two Ad Hoc Unsecured Noteholder Groups to defer one third of the Retention Grants to the Effective Date.

IV. The PBIP Motion

13. Through the PBIP Motion, the Debtors seek to extend the KERP to (i) 44 alleged non-insider upper-level management employees (the "**Non-Insider PBIP**"), PBIP Motion, ¶ 26, and (ii) eight insider executives (the "**Insider PBIP**"), PBIP Motion, ¶¶ 23, 24. The structure of the proposed Non-Insider PBIP and Insider PBIP is similar to that of the previously approved KERP, with a few notable exceptions.

14. Like the KERP, the Insider PBIP and Non-Insider PBIP contemplate allegedly performance-incentivizing payments based on three metrics: (i) revenue, weighted at 25%; (ii) adjusted EBITDA, weighted at 60%; and (iii) net broadband adds, weighted at 15%. PBIP Motion, ¶ 28. Payments will be earned quarterly for fiscal year 2020, payable two months after the end of each quarter. *Id*. Depending on the performance under each metric, payments will either be made at (i) "Threshold," representing a payment of 70% of "Target" for achieving 85% of each metric, (ii) "Target," representing a 100% payment for achieving 100% of each metric, or (iii) "Maximum," representing a payment of 130% of "Target" for achieving 115% of each metric. *Id.* For the first quarter for calendar year 2020, "performance metrics . . . were realized at approximately 89% of target," PBIP Motion, ¶ 6, with the adjusted EBITDA metric realized at approximately 103.5% of target. Declaration of Carlin Adrianopoli ("**Adrianopoli Declaration**") [Dkt. No. 499], ¶ 18. [redacted]

15. The Debtors request authorization to make aggregate payments of up to $13.57 million at the "Threshold" level, up to $19.38 million at the "Target" level, and up to $25.19 million at the "Maximum" level, for participants in both the Insider PBIP and Non-Insider PBIP, allocated between the two programs as follows:

Level	Insider PBIP	Non-Insider PBIP	Total
Threshold	$8,673,000	$4,893,500	$13,566,500
Target	$12,390,000	$6,990,500	$19,380,500
Maximum	$16,107,000	$9,087,500	$25,194,500

16. Unlike the participants in the previously approved KERP, who will receive their retention payments quarterly, with one third of the retention payments deferred until the Effective Date, the Insider PBIP and Non-Insider PBIP participants received the entirety of their retention payments pre-bankruptcy.

17. Additionally, unlike the 390 KERP participants, the Insider PBIP and Non-Insider PBIP participants are either executives or upper management. The eight Insider PBIP participants include the Chief Executive Officer and seven other "C-suite" executives. The 44 Non-Insider PBIP participants include 36 employees who report directly to "C-suite" executives; as discussed in Point II below, at least four of these employees appear to be insiders.

18. Through the PBIP Motion, the Debtors seek to have the RCA Program continued with respect to 41 of the Non-Insider PBIP participants (including the four who appear to be insiders), in the aggregate amount of $4.23 million, with $2.19 million payable in February 2021 and $2.04 million payable in February 2022. PBIP Motion, ¶ 39.

V. The Management Incentive Plan

19. On May 15, 2020, the Debtors filed their *Joint Plan of Reorganization of Frontier Communications Corporation and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code* [Dkt. No. 281], and on June 26, 2020, the Debtors filed their *Amended Joint Plan of Reorganization of Frontier Communications Corporation and its Debtors Affiliates Pursuant to Chapter 11 of the Bankruptcy Code* [Dkt. No. 612] (the "**Plan**"). The Plan provides for a "Management Incentive Plan Pool" of up to "six percent of the fully diluted New Common Stock," which will be reserved for grants to be made to management employees of the Reorganized Debtors at the discretion of the New Board. Plan, Art.I.119, Art.IV.Q.

OBJECTION

20. The Bankruptcy Code sets forth different standards for approving employee and management compensation plans, depending on whether the plan is made in or outside the ordinary course of business, whether it applies to insiders, and whether it is retentive or incentivizing in nature. Transfers made in the ordinary course are evaluated under section 363(c) of the Bankruptcy Code, while transfers made to insiders or transfers made outside the ordinary course of business are subject to the requirements of section 503(c) of the Code. *See, e.g.*, *In re Residential Capital, LLC*, 491 B.R. 73, 82 (Bankr. S.D.N.Y. 2013). In seeking approval of a proposed employee compensation arrangement, the debtor bears the burden of proof. *See, e.g., In re Hawker Beechcraft*, 479 B.R. 308, 313 (Bankr. S.D.N.Y. 2012); *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 237 (Bankr. N.D. Tex. 2009); *In re Alpha Natural Resources, Inc.*, 546 B.R. 348, 357 (Bankr. E.D. Va. 2016).

21. Here, the Debtors invoke each of the above provisions, contending that the Insider PBIP and Non-Insider PBIP can be approved under Section 363(c) as ordinary course transactions, and that, even if the programs are not ordinary course transactions, they satisfy the standards of

section 503(c). Both arguments fail. The Debtors have not fulfilled their burden of showing that the Insider PBIP and Non-Insider PBIP are consistent with their prepetition compensation plans or with industry-wide standards. In addition, the Debtors cannot satisfy the more stringent standards of section 503(c), as the programs are above market (especially in light of the retention bonuses already paid to insider and upper management employees), the performance goals are too easily attained, and the timing of the programs does not cover the entire bankruptcy period. Therefore, as discussed further below, the Insider PBIP and Non-Insider PBIP are neither properly incentivizing nor justified by the facts and circumstances of these cases. For these and other reasons that follow, the PBIP Motion should be denied.

I. The Insider and Non-Insider PBIPs Do Not Qualify as "Ordinary Course" Transactions

22. As a preliminary matter, the Insider PBIP and Non-Insider PBIP are not, despite the Debtors' assertions to the contrary (PBIP Motion, ¶¶ 60-62), ordinary course transactions that can be implemented under Section 363(c) of the Bankruptcy Code. To determine whether a transaction is in the ordinary course of business, courts conduct both a vertical analysis, which looks at the debtor's prepetition practices and conduct, and a horizontal test, which looks at whether the transaction is of the type commonly undertaken by peers in the debtor's industry. *See In re Johns-Manville Corp.*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986). Both tests must be satisfied. Burlington N. R.R. Co., v. Dant & Russell, Inc. *(In re Dant & Russell)*, 853 F.2d 700 (9th Cir. 1988).

23. Here, the Debtors fail to meet their burden with respect to at least the horizontal dimension of the ordinary course analysis. The Debtors contend that incentive programs "are customarily used by similarly-situated companies to drive financial performance and the attainment of key events in chapter 11 cases" and that the Insider PBIP and Non-Insider PBIP are

"consistent with programs approved in recent chapter 11 cases of similar size and complexity." PBIP Motion, ¶ 61. The "benchmarking analysis" set forth in the Georgeson Declaration compares the total cost of the Insider PBIP with the total cost of incentive plans approved in twelve other chapter 11 cases involving companies in various industries with revenues that exceeded approximately $2.0 billion and concludes that the cost of the Insider PBIP, both in the aggregate and as a percentage of projected revenues, is between the 50^{th} and 75^{th} percentiles. Georgeson Declaration, ¶¶ 26-28. The Georgeson Declaration omits, however, any information regarding the amounts awarded *per participant* in the comparison incentive plans. The per-participant amounts awarded under Debtors' Insider PBIP are likely to be much higher than the comparison group due to the small number of participants in the proposed Insider PBIP. Nor does the Georgeson Declaration specify the metrics used in the comparison incentive plans or the target levels for those metrics. And, problematically, the comparison group is primarily constituted of companies outside of Debtors' industry. *See In re Johns-Manville Corp.*, 60 B.R. at 616 (noting that courts look to an "industry-wide comparison" in analyzing the horizontal dimension of whether a transaction is in the ordinary course of business).

24. The Debtors also benchmarked total direct compensation levels (the sum of base salary, retention awards, and incentive awards) for the purported non-insiders against a general industry executive compensation survey and assert that if the Non-Insider PBIP is approved, aggregate target total direct compensation opportunities for Non-Insider PBIP participants would fall approximately 6 percent below the 50^{th} percentile. Georgeson Declaration, ¶¶ 31-32. As with the benchmarking analysis for the Insider PBIP, the Debtors fail to specify whether compensation under the Non-Insider PBIP is consistent with industry standards on a per-participant basis and with respect to the metrics used and the target levels for those metrics. Since the PBIPs are not

consistent with industry practice, the Debtors have not met their burden to prove that the Insider PBIP and Non-Insider PBIPs are ordinary course transactions, whether or not the plans are consistent with the Debtors' prepetition practice.

25. In addition it is unclear whether the Debtors satisfy the vertical dimension of the ordinary course analysis. While the Debtors contend in conclusory fashion that the Inisder and Non-Insider PBIPs are "a continuation" of the Debtors' prepetition practices, the Debtors fail to provide sufficient details concerning their prior incentive plans. PBIP Motion, ¶ 61. In addition, Debtors made several modifications to their compensation programs while contemplating filing for chapter 11 bankruptcy in the second half of 2019. Among other changes, the Debtors decreased the threshold under the incentive portion of their compensation program from 90% to 85%, and they removed the "gatekeeper" requirement that the Debtors' achieve 93% of the adjusted EBITDA metric before participants could receive any payouts.[4] These modifications make it much easier for plan participants to earn bonuses, and they are more than mere refinements of the Debtors' historical practices.

II. At Least Four Participants in the "Non-Insider" PBIP Appear to be Insiders

26. The Debtors seek approval of the Non-Insider PBIP as to 44 employees who "perform important business functions that are critical to the Debtors' day-to-day operations." PBIP Motion, ¶ 26. Many of the Non-Insider PBIP participants have high-ranking titles, such as "senior vice president," "group vice president," "chief," or "secretary." *Id.* ¶ 27. Employees holding such titles are presumptively considered Insiders, and debtors bear the burden of providing evidence to rebut that presumption. *In re Foothills Texas, Inc.*, 408 B.R. 573, 579-80 (Bankr. D. Del. 2009).

[4] *See* [redacted]

27. Based on their titles, reporting structures, and responsibilities, at least four of the Non-Insider PBIP participants — all Senior Vice Presidents with a high level of responsibility — appear to be insiders:

- Donald Daniels is SVP, Chief Accounting Officer. In addition to his C-suite title, Mr. Daniels is designated as a Securities and Exchange Commission Section 16 officer, he signs the Debtors' 10-K as its principle accounting officer, and he is listed as an executive officer in the 10-K. Nearly three-quarters of the Debtors' financial function by headcount sits below Mr. Daniels.
- Robert Curtis is SVP, Chief Marketing Officer. In addition to his "Chief" title, he is in charge of the Debtors' entire marketing function.
- Michael Shippey is SVP, Wholesale Sales, and is in charge of the Debtors' wholesale/carrier strategy.
- Kevin Saville is SVP, General Counsel and Assistant Secretary and has responsibility for the Debtors' litigation, contracts, securities, and intellectual property.[5]

28. While the Debtors assert in conclusory fashion that none of the Non-Insider PBIP participants "control or dictate the Debtors' overall strategy," they have not produced sufficient evidence to overcome the presumption that these employees are in fact insiders. To the extent Non-Insider PBIP participants are insiders, they are prohibited from receiving the post-petition retention payments promised them under the Non-Insider PBIP. *See infra* Point III.

III. The Proposed Payments to Insiders are Not Sufficiently Incentivizing

29. Section 503(c)(1) of the Bankruptcy Code prohibits a debtor from making retention payments to insiders without satisfying rigorous standards (which the Debtors do not claim to meet here). 11 U.S.C. § 503(c)(1).[6] In light of the severe limitations on insider retention plans, the burden is on the debtor to prove that a proposed *incentive* plan is not actually a *retention* program governed by Section 503(c)(1). *See In re Hawker Beechcraft Corp.*, 479 B.R. 308, 313 (Bankr.

[5] *See, e.g.,* [redacted]
[6] The Debtors acknowledge that the Insider PBIP Participants are "insiders." PBIP Motion, ¶ 25.

S.D.N.Y. 2012); *In re GT Advanced Techs., Inc.*, No. 14-11916-HJB, 2015 WL 5737181, at *5 (Bankr. D.N.H. Sept. 30, 2015) ("a debtor's label of a plan as incentivizing…must be viewed with skepticism"); *In re Residential Capital, LLC*, 478 B.R. 154, 170 (Bankr. S.D.N.Y. 2012) ("[T]he Debtors must establish by a preponderance of the evidence that the KEIP is primarily incentivizing and not primarily retentive"). The label a debtor attaches to its plan is not controlling, *In re Residential Capital, LLC*, 478 B.R. at 170, and "a Court must be vigilant when analyzing the terms of a KEIP and be sure the KEIP is not a disguised KERP that is primarily intended to reward its participants for retaining their positions with the debtor," *In re Alpha Natural Resources*, 546 B.R. at 357. It is for the Court to "determine whether the proposed targets are designed to motivate insiders to rise to a challenge or merely report to work." *In re Hawker Beechcraft, Inc.*, 479 B.R. at 313 (citations omitted). *See also In re PG&E Corp.*, No. 19-30088 (DM), 2019 WL 4686765, at *2 (Bankr. N.D. Cal. Aug. 30, 2019) (rejecting proposed KEIP as insufficiently challenging where Debtors had regularly achieved threshold performance).[7]

30. Here, the Debtors argue that Section 503(c)(1) does not govern the Insider PBIP because the program is incentivizing and not retentive in nature, and thus the Court should approve the Insider PBIP under the less stringent standard of Section 503(c)(3). PBIP Motion, ¶¶ 53-56. They are wrong. The adjusted EBITDA metrics in the proposed programs are so easily achieved that they render the programs, in essence, retention plans. *See In re Hawker Beechcraft*, 479 B.R. at 313 (denying proposed KEIP); *In re Residential Capital, LLC*, 478 B.R. at 172 (rejecting proposed KEIP, holding that "the Debtors must more closely link vesting of the KEIP Awards to metrics that are directly tied to challenging financial and operational goals for the business….");

[7] The retention bonuses paid to the eight insider executives (and to any upper management employees who should also be deemed insiders) prior to Debtors' bankruptcy filing are indisputably retentive and, therefore, would have been prohibited under the Bankruptcy Code if the Debtors had sought to make those payments after filing for chapter 11 relief.

In re PG&E Corp., 2019 WL 4686765, at *2 ("At least at the threshold level of performance, it is unclear what, if any, difficulty is present in achieving this performance"). And because the Debtors have not sought to (nor could they) satisfy the requirements of Section 503(c)(1), the Insider PBIP, and the Non-Insider PBIP to the extent its participants are insiders, should not be approved.

31. The adjusted EBITDA metric is not properly incentivizing because it is too easily achieved. Although the Debtors assert that the performance metrics are "attainable but sufficiently difficult to achieve," PBIP Motion, ¶ 6, the PBIPs set such low threshold and target metrics for adjusted EBITDA, and weight EBITDA so heavily, that PBIP participants are likely to receive large payments under the program even if they fail to achieve their targets.

32. The core problem is that the adjusted EBITDA targets are equal to the adjusted EBITDA amounts forecast in the Debtors' 2020 budget. Thus, the targets appear to reflect the outcomes the Debtors consider most likely, rather than stretch goals for financial performance. *See In re Hawker Beechcraft, Inc.*, 479 B.R. at 313 (holding that proposed Executive KEIP was not properly incentivizing where certain metrics matched the debtors' business plan); *In re GT Advanced Techs., Inc.*, 2015 WL 5737181, at *5 (holding that proposed KEIP was primarily a disguised retention plan where the plan's targets aligned with the debtors' business plan). An event that is "likely to occur" should not be the trigger for an incentive award. *See In re Hawker Beechcraft, Inc.*, 479 B.R. at 314.

33. Indeed, program participants have already exceeded their first quarter adjusted EBITDA target. For the first quarter of 2020, the Debtors achieved 103.5% of their adjusted EBITDA target. Adrianopoli Declaration, ¶ 18. Moreover, the adjusted EBITDA goal for each of the remaining quarters is significantly *lower* than the first quarter goal [redacted]

[redacted][8]

Without information from the Debtors concerning the formulation for these quarterly targets, it appears that the adjusted EBITDA targets may become even easier to achieve as the fiscal year progresses. Courts have rejected proposed KEIPS where, as here, "the largest component of the KEIP is primarily retentive." *In re Residential Capital, LLC*, 478 B.R. at 172.

34. Since adjusted EBITDA is weighted much more heavily (at 60%) than revenue (25%) and net broadband adds (15%) under the proposed PBIPs, Adrianopoli Declaration, ¶ 16, these easily achieved adjusted EBITDA targets are likely to result in participants receiving significant payments even if they fail to achieve their targets for the other metrics — as they did in the first quarter of 2020, when Debtors reached metrics levels resulting in a significant payout despite achieving the target only for the adjusted EBITDA metric and despite missing the net broadband adds target by a wide margin.

35. A further problem is that the PBIPs award substantial payouts — "threshold" awards equal to 70% of target awards — even if participants *underperform*, by merely attaining 85% of the adjusted EBITDA target (which, as noted, is simply budgeted adjusted EBITDA). The Debtors' executives and upper management employees should not receive hefty bonuses for significantly underperforming the Debtors' budget, which itself represents a likely outcome rather than stretch performance. *See In re Hawker Beechcraft*, 479 B.R. at 315 (rejecting proposed KEIP because "goals at the lower end" of the plan were not sufficiently incentivizing). To better incentivize performance, adjusted EBITDA targets should be adjusted upwards, *and* either (i) the

[8] Target adjusted EBITDA for 2020 under the PBIPs is $2.782 billion, threshold is $2.365 billion (85% of Target), and maximum is $3.199 billion (115% of Target). Broken down by quarter, target adjusted EBITDA is as follows: $756 million for Q1, $716 million for Q2, $662 million for Q3, and $647 million for Q4. Thus, the adjusted EBITDA target for the second quarter is 5.3% lower than the target for the first quarter; the third quarter target is 12.4% lower than the first quarter target; and the fourth quarter target is 14.4% lower than the first quarter target.

threshold level should be raised to a higher percentage of that target to be more challenging or (ii) the payment level earned at threshold performance should be decreased. Such modifications would better incentivize participants to stretch to reach challenging performance goals to the benefit of both the Debtors and their creditors.

IV. The Insider and Non-Insider PBIPs Do Not Satisfy the Requirements of Section 503(c)(3)

36. Even if the Court were to consider the Insider and Non-Insider PBIPs an "incentive program," rather than a disguised retention plan, neither plan satisfies the requirements of Section 503(c)(3) or Section 363(b) of the Bankruptcy Code. Section 503(c)(3) prohibits payments outside the ordinary course of business that are "not justified by the facts and circumstances of the case," and Section 363(b) requires the Debtors to show a "sound business purpose" for using estate property outside the ordinary course of business. 11 U.S.C. §§ 503(c)(3), 363(b). *See Official Comm. of Unsecured Creditors of LTV Aerospace and Defense Co., v. LTV Corp.*, (*In re Chateaugay Corp.)*, 973 F.2d 141, 143 (2d Cir. 1992); *Comm. of Equity Sec. Holders v. Lionel Corp.*, (*In re Lionel Corp*.), 722 F.2d 1063, 1070 (2d Cir. 1983). Courts in the Second Circuit have found that the "facts and circumstances" test is functionally identical to the business judgment standard established by section 363(b). *In re Velo Holdings, Inc*., 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012); *In re Borders Grp. Inc.*, 453 B.R. 459, 473-74 (Bankr. S.D.N.Y. 2011); *In re Dana Corp*., 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006).

37. Here, the Insider PBIP and Non-Insider PBIP are not supported by a "sound business purpose." In determining whether a sound business purpose exists, courts look to (i) whether the plan is consistent with industry standards, (ii) whether the cost of the plan is reasonable, (iii) whether the plan is calculated to achieve the desired performance, (iv) whether the scope of the plan is reasonable, (v) the diligence of efforts of the debtors in developing the

plan, and (vi) whether the debtor received independent counsel in developing the plan. *In re Dana Corp.*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006) (emphasis added). These factors weigh decidedly against approving the PBIPs.

A. Payments Per Participant Are Excessive

38. The costs of the Insider PBIP and Non-Insider PBIP are not reasonable, because payments per participant are much higher than necessary to incentivize participants to achieve the Debtors' goals. The Debtors seek to implement a $16.1 million Insider PBIP and a $9.1 million Non-Insider PBIP, for a total of $25.2 million if the Debtors achieve their maximum performance goals. The Debtors claim that the total costs of the programs is comparable to the Debtors' market peers. PBIP Motion ¶ 47. But the amounts to be awarded per participant appear to be exceedingly high relative to other companies and cannot be justified by the facts and circumstances of this case, especially in light of the fact that the Individual PBIP and Non-Insider PBIP participants have already received pre-paid retention bonuses for 2020 and are eligible for additional future compensation.[9]

39. The Debtors seek to implement the Insider PBIP for eight insider executives. These executives received, on average, a $1.2 million pre-petition retention bonus. Under the Insider PBIP, the insiders would be eligible to receive an additional $1.5 million for target performance and $2 million for maximum performance. These per participant awards are high compared with

[9] In addition to the proposed programs at issue in the PBIP motion, both the Insider PBIP and Non-Insider PBIP participants received prepetition incentive and retention payments. The Insider PBIP participants received [redacted] in the aggregate in February 2020, and the Non-Insider PBIP participants received [redacted] in aggregate retention payments in October and November 2019. Additionally, the PBIP participants are eligible for future grants under the Management Incentive Plan, from a pool of up to six percent of reorganized Debtor's stock, and most of the Non-Insider PBIP participants are eligible for future RCA grants. The Insider PBIP participants are also entitled to significant severance payments, and any payments under the Insider PBIP must be evaluated in the context of those potential severance benefits.

awards granted to insiders by peer companies and should be reduced to be consistent with industry standards.

40. The Debtors also seek to implement the Non-Insider PBIP with respect to 44 upper management employees. Under the Non-Insider PBIP, the management employees would be eligible to receive about $159,000 for target performance and $207,000 for maximum performance, on top of pre-paid retention bonuses and other compensation for which they are eligible. As with the Insider PBIP, the amounts awarded under the Non-Insider PBIP per participant are above market and should be modified to better confirm with plans implemented by the Debtors' peer companies.

B. The Insider and Non-Insider PBIPs Are Not Well Calculated to Achieve the Debtors' Stated Goals

41. In two respects, the Insider PBIP and Non-Insider PBIP are not properly designed to achieve the Debtors' stated goals: "to achieve value-driving financial targets" and to "motivate and reward" participants for their efforts throughout the chapter 11 process. PBIP Motion, ¶ 46.

42. *First*, as discussed above at ¶¶ 31-35, the programs reward participants for achieving performance goals that will easily be met. Easily achievable quarterly payments are designed to retain employees, not to incentivize them to create value.

43. *Second*, because the programs will likely terminate before the Debtors emerge from bankruptcy, they do not properly incentivize participants to continue to perform diligently throughout the entirety of the chapter 11 process. Under the Insider and Non-Insider PBIPs, the Annual Incentives and Performance LTI will be paid in quarterly installments as soon as practicable after the end of each performance period. PBIP Motion, ¶ 28. The final performance period, the fourth quarter of 2020, will end on December 31, 2020, and the final payment for that quarter must be paid no later than February 28, 2021. *Id.* The Debtors are unlikely, however, to

have emerged from bankruptcy by that time. The Debtors filed these Chapter 11 Cases after reaching a Restructuring Support Agreement (the "**RSA**") which provides that a Chapter 11 Plan will become effective within twelve months of the Petition Date. The outside date for the effective date of the Chapter 11 Plan may be extended by an additional six months to up to eighteen months from the Petition Date. RSA, p. 9. In other words, the RSA contemplates consummation of a Chapter 11 Plan by April 2021 (twelve months after the Petition Date), and the deadline for emergence from bankruptcy may be extended until October 2021 (eighteen months after the Petition Date). As such, the last of the PBIP payments will be paid at least two months before the Chapter 11 Plan effective date deadline, and potentially as much as eight months before the Chapter 11 Plan becomes effective. PBIP Motion, ¶ 28. The PBIP payment schedule does not, therefore, properly motivate participants to continue to create value throughout the entire bankruptcy period.[10]

44. To better achieve the Debtors' goal of motivating performance throughout the bankruptcy period, the proposed Insider PBIP and Non-Insider PBIP should be modified to extend over five quarters instead of four quarters, without increasing the total cost of either program. The Debtors should be required to formulate performance targets extending at least through March 2021, and they should modify the proposed payments amounts for the rest of 2020 to reserve a pool from which to grant the additional incentive payments for the first quarter of 2021.

[10] Moreover, the Insider and Non-Insider PBIP reward participants for work performed at the beginning of 2020, when the PBIPs had not yet been approved by the Debtors' Compensation Committee nor, of course, by this court. Payments for work already performed rather than for future performance obviously cannot be incentivizing. *See In re Residential Capital*, 478 B.R. at 161 ("an employee 'incentive' plan should incentivize employees for their post-petition efforts, not compensate them for the work they did before the bankruptcy filing").

V. Pre-Petition Retention Payments Should Remain Subject to Recapture Until the Debtors Emerge From Bankruptcy

45. As discussed previously, both the Insider PBIP and Non-Insider PBIP participants received substantial prepetition retention payments. The Insider PBIP participants received "the retention-based component of the[ir] 2020 compensation," [redacted] in the aggregate, in February 2020, and the retention payments are subject to recapture until the earlier of February 28, 2021, and the Debtors' emergence from chapter 11. PBIP Motion, ¶ 4, n.3. The Non-Insider PBIP participants received [redacted] in aggregate retention payments in October and November 2019, subject to recapture until April 15, 2021. *Id.* In order to properly encourage the retention of executive and upper management employees during the bankruptcy cases, retention payments to the Insider PBIP participants should be subject to recapture until either February 28, 2021 or the Debtors' emergence from bankruptcy, whichever occurs *later*. Similarly, the retention payments to the Non-Insider PBIP participants should be subject to recapture until the *later* of April 15, 2021 and the Debtors' emergence from bankruptcy.

* * *

46. The Insider PBIP and Non-Insider PBIP, as currently proposed, are primarily retentive and cannot be justified based on the facts and circumstances of these Chapter 11 cases. The programs' performance goals are not adequately challenging, and neither the thresholds for or the timing of the programs is reasonably calculated to achieve the Debtors' desired result of motivating its executive and upper management employees "to achieve value-driving financial targets" throughout the entire bankruptcy period.

47. Accordingly, the Committee respectfully requests that the Insider PBIP and Non-Insider PBIP be modified as follows: 1) the target levels for adjusted EBITDA should be raised to levels that are appropriately incentivizing; 2) the threshold levels for adjusted EBITDA should

be raised to a higher percentage of target or, alternatively, the payment levels earned at threshold performance should be decreased; 3) the proposed programs should extend over five quarters rather than four to better span the duration of the Chapter 11 Cases, and the Debtors should make payments for all five quarters without increasing the total cost of the programs; 4) pre-paid retention bonuses should be subject to recapture at least until the Debtors' emergence from Chapter 11; and 5) the total and per participant payments under the Insider PBIP and Non-Insider PBIP should be reduced consistent with industry standards.

CONCLUSION

WHEREFORE, for the reasons set forth herein, the Court should deny the PBIP Motion unless modified as described herein, and grant other relief as necessary and appropriate.

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Respectfully submitted,

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