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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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| In re: | : | Chapter 11 |
| | : | |
| Journal Register Company, et al. | : | Case No. 09-10769 (ALG) |
| | : | |
| Debtors. | : | Jointly Administered |
| | : | |

**OBJECTION OF THE STATE OF CONNECTICUT TO DEBTORS' MOTION FOR ORDER AUTHORIZING PAYMENT OF INCENTIVE PAY TO OFFICERS AND KEY EMPLOYEES PURSUANT TO SECTIONS 105(a), 363(b)(1) AND 503(c)(3) OF THE BANKRUPTCY CODE**

The State of Connecticut, a creditor and party-in-interest in these proceedings, by and through its attorney, the Attorney General for the State of Connecticut, hereby objects to the Debtors' Motion For Order Authorizing Payment of Incentive Pay To Officers and Key Employees Pursuant to Sections 105(a), 363(b)(1) and 503(c)(3) of the Bankruptcy Code (the "Motion"). In support of its Objection, Connecticut respectfully represents as follows:

1. On February 21, 2009 (the "Petition Date"), the Debtors filed petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The Debtors continue to manage and operate their businesses and property as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed.

2. The Motion seeks authorization from this Court to pay bonuses totaling $1,711,000.00 to 31 officers and Key Employees (the "Key Employees") of the Debtors pursuant to a Management Incentive Plan dated December 8, 2008.

3. According to the Motion, the bonuses are linked to four specific post-petition events as follows: (a) the shutdown by February 28, 2009 of substantially all publications slated for elimination in the Debtor's Business Plan dated October 15, 2006 (the "Shutdown Objective"); (b) the elimination by March 31, 2009 of 450 full-time positions (the "Second Staffing Objective")[1]; (c) the achievement by the Debtors of a minimum of $16 million of EBITDA (earnings before interest, taxes, depreciation, and amortization) in the fourth quarter of 2008 and the first quarter of 2009 (the "EBITDA Objective"); and (d) the consummation of the Debtors' Plan of Reorganization (the "Emergence Objective"). The aggregate amounts to be paid in connection with each of these objectives are as follows: $468,000.00.00 for the Shutdown Objective; $486,000.00 for the Second Staffing Objective[2]; $486,000.00 for the EBITDA Objective; and $253,000.00 for the Emergence Objective.

4. For the reasons set forth more fully below, Connecticut objects to the payment of the proposed bonuses, as the Debtors have failed to demonstrate that the proposed bonuses are authorized under the Bankruptcy Code.

5. As a threshold matter, Connecticut submits that the Motion cannot be properly evaluated under any standard because it lacks certain relevant information. The Motion identifies the proposed beneficiaries of the bonuses only generally as certain "Officers and Key

[1] The "First Staffing Objective" of the Management Incentive Plan required the elimination of 140 full-time employees by December 31, 2009.

[2] This is over and above bonuses totaling $450,000.00 that were paid to the Key Employees prior to the Petition Date in connection with the "First Staffing Objective". Thus, the total amount of bonuses to be paid to the Key Employees under the Management Incentive Plan is $2,161,000.00.

Employees". The Debtors should provide the names and respective positions of the 31 Key Employees so that a determination can be made as to which Key Employees are insiders.

6. In addition, the Motion fails to provide complete information regarding the compensation package for each Key Employee, including actual base salary and whether there are any other components to their compensation besides their base salary and the proposed bonuses. Without a full picture of compensation each Key Employees is eligible to receive, it is impossible to determine the precise bonus amounts payable to each Key Employee and to evaluate the reasonableness of the proposed bonuses in light of other aspects of their compensation. *See In re Dana Corp.*, 358 B.R. 567, 583 ("in order to determine the reasonableness and cost effectiveness of the compensation levels, one must consider the total compensation that could be potentially be earned….")

7. Finally, with respect to the EBITDA Objective, there is insufficient information to determine whether the earnings benchmark is reasonable and deserving of increased compensation or whether the EBITDA threshold is set so low that the bonuses are virtually guaranteed to be paid.

8. Based on the information that has been provided by the Debtors, Connecticut submits that the proposed bonuses violate §§503(c)(1) and 503(c)(3) of the Bankruptcy Code and therefore should not be approved.

**<u>The Debtors Have Failed To Satisfy The Requirements of §503(c)(1) of the Bankruptcy Code</u>**

9. Connecticut submits that, to the extent at least some of the Key Employees are officers and therefore insiders under §101(31)(B)(ii) of the Bankruptcy Code, the relevance of §503(c)(1) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") to the subject Motion cannot be ignored.

10. The Debtors readily dismiss the requirements of §503(c)(1) as inapplicable by asserting that the proposed bonuses are performance incentives, which, unlike retention bonuses, are not subject to the criteria of §503(c)(1). However, the labels the Debtors have chosen to use do not render the requirements of §503(c)(1) inapplicable if the primary function of the bonuses is to induce the Key Employees to remain employed by the Debtors. *In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006).

11. Section 503(c)(1) of the Bankruptcy Code was enacted by Congress as a result of increasing public sentiment against the practice of executives of bankrupt companies generously rewarding themselves during restructuring while at the same time the rank and file workers were suffering tremendous economic blows as a result of the bankruptcy. *See In re U.S. Airways, Inc.*, 329 B.R. 793, 797 (Bankr. E.D. Va. 2005).

12. Prior to the enactment of §503(c)(1), the approval of executive retention plans were subject only to the relatively low threshold of the "business judgment standard". In enacting §503(c)(1), Congress sought to eliminate excessive executive compensation and widespread abuses of key employee retention plans ("KERPS") in bankruptcy by requiring debtors to satisfy certain strict evidentiary standards before a bankruptcy court could authorize payments to an insider for the purpose of inducing such person to remain with the debtor's business. *In re Dana Corp*., 351 B.R. at 100-101. Under §503(c)(1), a retention bonus cannot be approved unless a debtor establishes that: (a) the bonus 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) the bonus does not exceed the specific levels fixed by the statute. *See* 11 U.S.C. §503(c)(1).

13. Despite the label the Debtors have chosen to place on the proposed bonuses, a close examination of the Debtors' Motion and the so-called "performance incentives" reveals that the proposed bonuses are intended primarily to retain the Key Employees rather than reward them for the achievement of extraordinary results.

14. In the Motion, the Debtors admit that the proposed bonuses are necessary to retain the Key Employees. For example, the Motion states that "[a]uthorization to implement the [Management Incentive Plan] will provide the Debtors' employees with a greater sense of financial security thereby minimizing the need to seek other employment which would otherwise distract the employees from the necessary tasks they need to perform for the Debtors" (Motion, ¶ 30). The Motion also reveals that the proposed bonuses are intended to make up for the fact that "many of [the Key Employees] have already had to sacrifice components of their compensation as a result of the Debtors' circumstances," including the elimination of certain benefits such as 401(k) matching.

15. Although it may be permissible for incentive plans to have some components that arguably have a retentive effect, *In re Dana Corp.*, 351 B.R. at 103, the proposed bonuses are predominantly retentive in nature. The incentivizing nature of these bonuses is belied by a number of other factors. First, some of the bonuses are linked to performance that has already occurred. For instance, the deadline for completing the Shutdown Objective was February 28, 2009 and there is less than one month left in the six-month time period that will determine whether the EBITDA Objective has been met. If the true objective of an incentive payment is to provide motivation for future performance, it is difficult to see how bonuses linked to tasks that have already been completed or events that have already occurred will fulfill that function.

16. Secondly, the Motion seeks to award bonuses to ten of the Key Employees upon the consummation of the Plan of Reorganization. Despite the Debtors' assertion that these

bonuses would reward the significant efforts required to affect the restructuring of the Debtors, the true purpose of these bonuses is clearly retention, as they are not linked to any particular performance goals. Indeed, the Court rejected a similar "completion bonus" in the case of *In re Dana Corp*, 351 B.R. 96 (Bankr. S.D.N.Y. 2006), holding that the bonus, which was tied to nothing more than a requirement that the executive remain with the company until the Effective Date, could not be characterized as an incentive bonus. *In re Dana Corp.*, 351 B.R. at 102. Moreover, unlike many Chapter 11 cases, where the reorganization process is far from certain and consummation of a plan of reorganization may not occur for years, the Plan in this case has already been negotiated and filed and is virtually assured of confirmation and consummation within a few short months. Thus, any bonus linked to the Emergence Objective amounts to nothing more than a guaranteed gift to the Key Employees.

17. Connecticut submits that, with respect to the insiders, since the predominant intent of the proposed bonuses is to provide rewards for staying with the company, the Motion should denied on the ground that the Debtors have failed to satisfy their evidentiary burden under §503(c)(1) of the Bankruptcy Code.

**<u>The Proposed Bonuses Do Not Meet the Standard of §503(c)(3) of the Bankruptcy Code</u>**

18. Even if the Court determines that the requirements of §503(c)(1) do not apply, Connecticut submits that the proposed bonuses should not be approved because they fail to satisfy the criteria of §503(c)(3) of the Bankruptcy Code which provides:

> there shall neither be allowed, nor paid…other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

11 U.S.C. §503(c)(3).

19. It is patently clear that under the facts and circumstances of this case the proposed bonuses are not justified.

20. First, the Debtors' decision to reward its executives with nearly $1 million for eliminating 590 full-time employees in the midst of the current economic crisis not only demonstrates highly questionable judgment, poor taste, and total lack of sensitivity, but is completely unjustifiable. The fact that the Debtors need to make significant reductions to its workforce is bad enough, but the Debtors merely add insult to injury when they "reward" a select few for "accomplishing" this task. It is submitted that, under the facts and circumstances of this case, the estate, as well as the interests of justice would be better served if the $1 million were used to retain even a few of the positions slated for elimination or to provide some recovery to the unsecured creditors.

21. Secondly, although the Motion frequently cites as justification for the bonuses the need for the Key Employees to focus on the restructuring effort, the Debtors have hired, at great expense to the estate, numerous bankruptcy professionals and crisis managers for the specific purpose of focusing on the restructuring effort. Among the professionals retained is the firm of Conway, Del Genio, Gries & Co., LLC to serve as the Debtors' Chief Restructuring Officer ("CFO"). The CFO has been employed by the Debtors since July 23, 2008 at an average monthly fee of $260,000.00 plus expenses. To date, the Debtors have expended over $1,700,000 for the CFO's services. The payment of bonuses to the Key Employees for services already being provided by the CFO and the other professionals simply cannot be justified.

22. The Motion also attempts to justify the bonuses on the ground that the bonuses will motivate the Key Employees to maximize creditor recoveries. However, under the facts and circumstances of this case, any promise of potential benefit to the unsecured creditors is purely illusory. As noted above, the Debtors pre-packaged Plan of Reorganization has already been

filed and is likely to be consummated within a few short months. The Debtors' Plan provides that general unsecured creditors and equity holders will receive nothing. In the short time between the Petition Date and confirmation, it is highly unlikely that the Key Employees will be able to effect any tangible improvement to the treatment of unsecured creditors. In fact, there is a greater likelihood that the unsecured creditors will benefit if the $1,700,000 in proposed bonuses remains in the estate.

23. Connecticut submits that none of the performance objectives appear to require the Key Employees to act above and beyond the level required by their normal fiduciary duties or perform tasks for which they are not already being adequately compensated. Under the circumstances of this case, the proposed bonuses simply cannot be justified, as they would reward the Key Employees for simply staying on and doing their jobs rather than achieving extraordinary results for the Debtors and its creditors in the future.

24. To the extent the "business judgment standard" and/or §363(b) of the Bankruptcy Code impose a standard for approval of the proposed bonuses that is less stringent than that set forth in §503(c)(3), Connecticut submits the Debtors' reliance on them is misplaced and that the §503(c)(3) standard controls. However, even if the proposed bonuses are evaluated under the less stringent business judgment rule, they should be denied because they do not reflect the exercise of sound business judgment on the part of Debtors for the reasons already set forth above.

Wherefore, the State of Connecticut respectfully asks that the Debtors' Motion for Order Authorizing Payment of Incentive Pay To Officers and Key Employees Pursuant to Sections 105(a), 363(b)(1) and 503(c)(3) of the Bankruptcy Code be denied.

Dated : March 4, 2009
Hartford, Connecticut

STATE OF CONNECTICUT

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## CERTIFICATION OF SERVICE

I hereby certify that, on this 4th day of March, 2009, a copy of the foregoing Objection of the State of Connecticut Department To Debtors' Motion For Order Authorizing Payment of Incentive Pay To Officers and Key Employees Pursuant to Sections 105(a), 363(b)(1) and 503(c)(3) of the bankruptcy Code was served through the Court's Electronic Case Filing System and sent by first class mail, postage prepaid, to the following:

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