UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Hearing Date: June 26, 2012
Hearing Time: 11:00 a.m.

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In re

Arcapita Bank B.S.C. (c), *et al.*,

Debtors.

Chapter 11

Case No. 12-11076 (SHL)

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OBJECTION OF THE UNITED STATES TRUSTEE TO MOTIONS OF DEBTORS (1) FOR ORDER AUTHORIZING THE DEBTORS TO FILE UNDER SEAL CONFIDENTIAL EMPLOYEE INFORMATION, AND (2) FOR AN ORDER AUTHORIZING DEBTORS TO IMPLEMENT EMPLOYEE PROGRAMS AND GLOBAL SETTLEMENT OF CLAIMS

TO: THE HONORABLE SEAN H. LANE,
UNITED STATES BANKRUPTCY JUDGE:

Tracy Hope Davis, the United States Trustee for Region 2 (the "United States Trustee"), by and through her counsel, in furtherance of the duties and responsibilities set forth in 28 U.S.C. §§ 586(a)(3) and (5), hereby respectfully files her objection to the Motions of Debtors (1) for an Order Authorizing the Debtors to File under Seal Confidential Employee Information (the "Sealing Motion"), and (2) Authorizing the Debtors to Implement Employee Programs and Global Settlement of Claims (the "Employee Motion"). ECF Doc. No. 205.

SUMMARY OF ARGUMENT

The United States Trustee objects to both the Sealing Motion and the Employee Motion. The Sealing Motion walls off parties-in-interest from the very information they need to evaluate the merits of the Employee Motion. The Motion contains no authority to support the proposition that the sealing of documents is appropriate where, as here, the granting or denial of the

accompanying substantive motion hinges on the full disclosure of its terms. In particular, the information to be excluded from public view, namely, the amounts to be paid to individual employees under the bonus programs, is essential to an evaluation of the reasonableness of the bonus payments.

As to the Employee Motion, not only does it fail to set forth adequate information concerning the amount of the bonuses that employees are to receive under the bonus programs, but it also fails to adequately address the performance goals that are to trigger the payment of those bonuses. Furthermore, the debtors have failed to meet their burden of proof to show that the proposed bonus payments comply with Sections 503(c) and 363 of the Bankruptcy Code.

Finally, the Employee Motion is silent as to the benchmarks that the debtors must attain in order to trigger the bonuses. If the debtors do not disclose how high they are setting the bar, there is no way the Court and parties-in-interest can evaluate whether the proposed bonuses hinge on the debtors' performance or whether the bonus plan participants will receive bonuses whether or not Arcapita and its affiliates meet or exceed expectations.

For these and other reasons, both the Sealing Motion and the Employee Motion should be denied.

BACKGROUND

A. General

<u>The Case</u>

1. On March 19, 2012 (the "Petition Date"), Arcapita Bank B.S.C.(c), *et al.* (the "Debtors") commenced voluntary cases under chapter 11 of the Bankruptcy Code. ECF Doc. No. 1.

2. The Debtors remain in possession of their assets and continue to manage their businesses as debtors-in-possession pursuant to Bankruptcy Code Sections 1107(a) and 1108. To date, no trustee or examiner has been appointed in these Chapter 11 cases.

3. On April 2, 2012, the Debtors filed an Application to Employ Alvarez & Marsal North America, LLC ("Alvarez & Marsal") as Financial Advisors to Debtors and Debtors in Possession Pursuant to Sections 327(a) and 328 of the Bankruptcy Code. ECF Doc. No. 47.

4. On April 3, 2012, the Debtors filed an Application to Employ Rothschild Inc. and N M Rothschild & Sons Limited ("Rothschild") as Financial Advisors and Investment Bankers for the Debtors. ECF Doc. No. 53.

5. On April 5, 2012, the United States Trustee appointed an official committee of unsecured creditors (the "Committee"). ECF Doc. No. 60.

6. On May 4, 2012, the Debtors filed an Application to Employ KPMG LLP ("KPMG") as Valuation Advisor to the Debtors Pursuant to Sections 327(a) and 330 of the Bankruptcy Code. ECF Doc. No. 123.

7. By order entered on May 15, 2012, the Court authorized the retention of A & M on an interim basis. ECF Doc. No. 138.

8. By order entered on June 12, 2012, the Court authorized the retention of KPMG on an interim basis. ECF Doc. No. 241.

9. To date, the Debtors has not filed a sale motion, a plan, or a disclosure statement.

The Sealing Motion

10. On June 5, 2012, the Debtors filed the Sealing Motion. ECF Doc. No. 206.

11. The Debtors seek to deny public "[d]isclosure of the terms or conditions of the

KEIP and KERP (terms described below). . . ." Sealing Motion, ¶ 9.

The Employee Motion

12. On June 5, 2012, the Debtors filed the Employee Motion. ECF Doc. No. 205.

13. The Employee Motion consists of four parts: A "Global Settlement,"[1] a Severance Program,[2] a Key Employee Retention Program, and the Key Employee Incentive Program (the "KEIP"). The KEIP provides for performance-based incentive payments to 20 employees (collectively, the "KEIP Participants"). Employee Motion, ¶ 27. Of the KEIP participants, 4 are denominated as insiders.[3] Id.

14. Under the KEIP, incentive payments amount to between 3 to 12 months's wages. Id. at 30. The aggregate amount of payments under the KEIP is $3 million, id., an amount that "would increase if levels of performance exceed the milestones established KEIP performance goals." Id. at ¶ 30, n. 21. The Employee Motion does not define the milestones.

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[1]The Global Settlement is described by the Debtors as a cost-cutting measure that provides for, inter alia, share loan forgiveness to employees, many of whom are leaving Arcapita. See Employee Motion, ¶¶ 8-9. It would enable the Debtors to reduce expenses through a 96-employee reduction in force. Id. at ¶ 8. The United States Trustee takes no position regarding the Global Settlement.

[2]The Severance Program, another cost savings plan, see Employee Motion, ¶ 57, will cost the estates $4.5 million. Id. at ¶ 58. The Debtors expect to save $830,000 per month as a result of the Severance Program. Id. The Severance Program meets the numeric standards of Section 503(c)(2) of the Bankruptcy Code. See 11 U.S.C. § 503(c)(2); Employee Motion, ¶53.

[3]The remainder of the KEIP Participants are non-insiders. Employee Motion, ¶ 27. The Debtors explain that they included relatively high-ranking non-insiders in the KEIP "to avoid needless litigation over what constitutes an insider. . . ." Id. at ¶ 27 and n.19. Finally, the Employee Motion indicates that "the top seven members of Arcapita's senior management have voluntarily agreed to forgo cash benefits under the KEIP. . . ." Id. at ¶ 77.

DISCUSSION

A. Sealing Motion – Legal Standards

Legal Standards

Bankruptcy Rule 5001(b) provides, in pertinent part, as follows: "All trials and hearings shall be conducted in open court and so far as convenient in a regular court room." *See In re Global Crossing Ltd.*, 295 B.R. 720, 723-24 (Bankr. S.D.N.Y. 2003); *see also Brown v. Williamson Tobacco Corp. v. Federal Trade Comm'n*, 710 F.2d 1165, 1178 (6th Cir. 1983) (holding that the "open courtroom has been a fundamental feature of the American judicial system.") Thus, parties seeking to deny public access to court documents must overcome a strong presumption. *Neal v. The Kansas City Star* (*In re Neal*), 461 F.3d 1048, 1053 (8th Cir. 2006); *Gitto v. Worcester Telegram & Gazette Corp.* (*In re Gitto Global Corp.*), 422 F.3d 1, 6 (1st Cir. 2005).

In the bankruptcy context, the general rule of open access is set forth in Section 107(a) of the Bankruptcy Code, which provides, in part, that subject to certain limited exceptions,

> a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by an entity at reasonable times without charge.

11 U.S.C. § 107(a). *See In re Food Management Group, LLC,* 359 B.R. 543, 553-555 (Bankr. S.D.N.Y. 2007) (section 107 reflects Congress's intent to favor public access to papers filed with the bankruptcy court).

"The policy of open inspection, codified generally in Section 107(a) of the Bankruptcy Code, evidences Congress's strong desire to preserve the public's right of access to judicial

records in a bankruptcy proceeding." *In re Orion Pictures Corp.*, 21 F.3d 24, 26 (2d Cir. 1994); *In re Barney's, Inc.*, 201 B.R.703, 707 (Bankr. S.D.N.Y. 1996) ("Congress did not intend that sealed pleadings be the rule in bankruptcy cases"); *In re Alterra Healthcare Corp.*, 353 B.R. 66, 74 (Bankr. D. Del. 2006) ("Congress has codified the historical practice of open access in bankruptcy").

1. The Sealing Motion Fails To Demonstrate That The Statutory Exception To The General Policy Of Transparency Is Applicable Here

In the instant case, the Debtors seek to seal information that is essential to a determination of the merits of the accompanying Employee Motion. Specifically, the Debtors do not wish to disclose either the names and titles[4] of the employees who are to receive bonuses under the proposed bonus programs or the amounts these employees are to receive. Without such information, parties-in-interest would be deprived of the opportunity to ascertain whether the bonuses are reasonable and/or warranted under the circumstances of these Chapter 11 cases.

While Bankruptcy Rule 9018 explicitly excludes from disclosure materials in the nature "of a trade secret or other confidential research, development, or commercial information," Fed. R. Bankr. P. 9018(1), this exception does not apply here. Such an unsubstantiated statement is insufficient to meet a movant's burden under Section 107 and Bankruptcy Rule 9018. If a motion for a protective order is premised on the existence of confidential information, the movant must make "a particularized showing that the information sought to be protected is confidential commercial information. . . ." *Wall Indus., Inc. v. United States*, 5 Cl.Ct. 485, 487

[4]Although the Employee Motion states that "[t]he non-insider population within the KEIP is comprised solely of Employees with the title of director," Employee Motion, ¶ 27, nowhere do the Debtors explain what these directors' role is within the company.

(1984). The Debtors have failed to show that the names of the employees and/or their anticipated bonus payments constitute "a trade secret or other confidential research, development, or commercial information." Moreover, a determination of the merits of the Debtors' KEIP depends in large part on which of the affected employees is an "insider." Without knowing the identities of the plan participants, parties-in-interest cannot know which of these employees may be insiders. Instead, parties-in-interest must simply accept the Debtors' representation that only four insiders will participate in the KEIP. See Employee Motion, ¶ 27.

B. The Employee Motion

In the Employee Motion, the Debtors are asking the Court for authorization to implement complex bonus programs while providing incomplete information as to the performance metrics that will trigger those bonuses (see argument below). Meanwhile, in the Sealing Motion, the Debtors are asking the Court's permission to carve out an exception to the general rule of transparency in bankruptcy cases with respect to the amounts employees are to receive under the Bonus Plan. However, they cite no authority for this specific proposition. The Sealing Motion, if granted, would add another layer of secrecy to what should be an open process.

1. The Statutory Framework

Section 503 of the Bankruptcy Code governs the allowance of administrative expenses "for actual, necessary costs and expenses of preserving a debtor's bankruptcy estate." Because payments under the bonus program would be administrative claims, approval of the Agreement's incentive bonuses, severance pay and retention awards are subject to Section 503 of the Bankruptcy Code. See In re Dana Corp, 351 B.R. 96, 101 (Bankr. S.D.N.Y. 2006)("Dana I") (finding Section 503 applied to debtor's "assumption" of its executive compensation plan).

Section 503 governs the allowance of administrative expenses "for actual, necessary costs and expenses of preserving a debtor's bankruptcy estate." 11 U.S.C. § 503(b)(1)(A). The two general overriding policies of Section 503 of the Bankruptcy Code are: (i) to preserve the value of the estate for the benefit of its creditors and (ii) to prevent the unjust enrichment of the insiders of the estate at the expense of its creditors. In re Journal Register Co., 407 B.R. 520, 535 (Bankr. S.D.N.Y. 2009) (citing Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc., 789 F.2d 98. 101 (2d Cir. 1960)) (additional citations omitted).

Section 503(c)(1) of the Bankruptcy Code prohibits any transfer:

> made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that
>
> (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
>
> (B) the services provided by the person are essential to the survival of the business; and
>
> (C) either –
>
> (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
>
> (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

11 U.S.C. § 503(c)(1).

A transfer to an insider to induce the insider to remain with the debtor's business must satisfy the requirements under subdivisions (A), (B), and (C) of Section 503(c)(1) of the Bankruptcy Code to be subject to this subdivision's exception. 4 Collier on Bankruptcy ¶ 503.17 (15th ed. rev. 2007); see also In re Dana Corp., 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2007) ("Dana II") (summarizing the requirements under Section 503(c)(1) of the Bankruptcy Code). Attempts to characterize what are essentially prohibited retention programs as "incentive" programs to bypass the requirements of Section 503(c)(1) of the Bankruptcy Code are looked upon with disfavor, as the courts consider the circumstances under which particular proposals are made, along with the structure of the compensation packages, when determining whether the compensation programs are subject to section 503(c)(1) of the Bankruptcy Code. See In re Mesa Air Group, Inc., No. 10-10018, 2010 WL 3810899, at *2 (Bankr. S.D.N.Y. Sept. 24, 2010) (citing Dana I, 351 B.R. at 102 n.3(stating that if a bonus proposal "walks like a duck (KERP), and quacks like a duck (KERP), it's a duck (KERP).").

Section 503(c) of the Bankruptcy Code, added in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), was intended to curtail payments of retention incentives or severance to insiders, including bonuses granted to other employees without factual and circumstantial justification. See Journal Register; 407 B.R. at 535; see also In re Pilgrim's Pride Corp., 401 B.R. 229, 234 (Bankr. N.D. Tex. 2009) ("Section 503(c) was enacted to limit a debtor's ability to favor powerful insiders economically and at estate expenses during a chapter 11 case.") (citing In re Airway Indus., Inc., 354 B.R. 82, 87 n.12 (Bankr. W.D. Pa. 2006)) (additional citations omitted); In re Global Home Prods., LLC, 369 B.R. 778, 783-84

(Bankr. D. Del. 2007) (the amendments were added to "eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process.") This section establishes specific evidentiary standards that must be met before a bankruptcy court may authorize payments made to an insider for the purpose of inducing such person to remain with a debtor's business or payments made on account of severance. In re Borders Group, Inc., 453 B.R. 459, 470 (Bankr. S.D.N.Y. 2011); Dana I, 351 B.R. at 100; 11 U.S.C. § 503(c)(1). These amendments make it abundantly clear that if a proposed transfer falls within Section 503(c)(1) or (c)(2), then the business judgment rule does not apply, irrespective of whether a sound business purpose may actually exist. Id. The effect of Section 503(c) of the Bankruptcy Code was to put in place "a set of challenging standards" and "high hurdles" for debtors to overcome before retention bonuses could be paid. Borders, 453 B.R. at 470, (citing Global Home Prods., 369 B.R. at 785).

2. Payments Under the Bonus Plans are Unrelated To the Ultimate Success of the Case

The Debtor has not provided the Court with facts or its analysis to determine whether a reasonable relationship exists between the KEIP and KERP, on the one hand, and the results to be obtained, on the other. To pass statutory muster under BAPCPA, even under the less rigorous standards of Sections 503(c)(3) and 363, the benchmarks for the payment of bonuses must be "difficult targets to reach." Dana II, 358 B.R. at 583. Here, the Debtor has not explained how the bonus plan relates to the ultimate success of the Chapter 11 case. In fact, the Employee Motion fails to identify the targets at all.

In contrast to the instant case, the Court in Borders considered a Key Employee Incentive Plan where the incentive bonuses were originally not tied to a distribution to general unsecured

creditors. Borders, 453 B.R. at 472. The bonus plan ultimately approved by the court in that case provided that the key employees would receive "an additional bonus based on the size of the distribution made to general unsecured creditors." Id. The court approved the bonus plan, in part, because the executives' bonuses were subject to certain time limitations. Id. at 473. "[I]n addition to meeting the Incentives, [bonus] payments are also keyed to meeting fairly aggressive time-based goals." Id. As the court observed, time-based incentives are "beneficial to the estate because an expedited emergence will minimize administrative costs" and "maximize stakeholder value." Id. Neither the plan distribution incentive nor the time-based incentive is present in the bonus plan here.

Curiously, although the Employee Motion indicates that the KEIP payments are tied to performance goals, Employee Motion, ¶¶ 29-30, those goals are not identified anywhere in the Employee Motion. In addition, although the Employee Motion states that there are "[t]arget incentive payments under the KEIP," Id. at 30, the Employee Motion does not indicate what those "targets" may be. Without that essential information, the Court and parties-in-interest cannot possibly evaluate the reasonableness of the performance goals to which the bonus payments are ostensibly linked, let alone whether those goals are "difficult targets to reach." Dana II, 358 B.R. at 583.

Nowhere does the Employee Motion suggest that the KEIP bonuses hinge on the extent of a distribution to unsecured creditors under a confirmed plan. In fact, the bonuses do not appear to be contingent on the confirmation of *any* plan. Because of the failure of the Debtors to supply information concerning the metrics, it is entirely possible that the Key Employees will receive bonuses even if the Debtors' Chapter 11 cases do not result in a viable Chapter 11 plan. Also,

because of this deficiency, it is impossible to determine the impact that payments under the bonus plan will have on the estate and its creditors. Bonuses received by the Key Employees will not be made available to general unsecured creditors. Thus, because of the absence of a description of the benchmarks in the Employee Motion, the bonus plan's true cost to the estate is unknown.

3. The Debtors Have Failed to Satisfy Their Evidentiary Burden

a. The Debtors Have Failed to Satisfy Section 503(c)(1)

The law is clear that the burden is on the Debtors to either show that the proposed Annual Incentive Bonus and the Long Term Incentive Bonus comply with the requirements of section 503(c)(1) or that they are not disguised retention plans. See Dana I, 351 B.R. at 100; Mesa Air Group, 2010 WL 3810899, at *2 (citing Global Home Prods., 369 B.R. at 785). In order for the Debtor to satisfy the requirements of Section 503(c)(1), it must meet specific evidentiary standards before a bankruptcy court may authorize payments made to insiders to induce such individuals to remain with the company. Dana I, 351 B.R. at 100.

Retention plans usually are intended "to encourage certain crucial employees to remain with the company through a critical, transitional time period when the exact future of the company is unclear and when those employees would be most likely to search for other employment." Brooklyn Hosp., 341 B.R. at 413. Although the Debtor styles one of the bonus plans in question as an incentive plan, it fails to satisfy the stringent criteria necessary to show that the plan is not merely retentive. It is the substance of how and why the proposed payments are made, not the label put on the bonus plan, that is determinative.

The KEIP in the instant case appears to have features of both retention and incentive

plans. Although the bonus plan purports to contain certain financial milestones, the Employee Motion fails to identify them. By hiding the ball with respect to these milestones,[5] it is difficult to avoid reaching the conclusion that the Debtors' motivation is largely retentive. After all, if the Debtors seek to convince the Court and parties-in-interest that the purpose of the KEIP is to incentivize the plan participants, one would think that the Debtors would make every attempt to identify the incentives. Unfortunately, the Debtors have chosen instead to keep the terms of those incentives to themselves.[6]

Accordingly, Section 503(c)(1) does, in fact, govern the Employee Motion, insofar as bonuses to insiders are concerned. Unfortunately, the Debtors do not even attempt to argue that the Employee Motion passes muster under that subsection. The Debtor fails to establish that, among other things, the Key Employees have bona fide job offers with other companies at the same or greater rates or that either (a) the new proposed payments are less than ten times the mean of similar payments made to non-management employees during the calendar year, or (b) the proposed payments are less than 25 percent of the amount of any similar payments made to the Senior Managers in the prior year. 11 U.S.C. § 503(c)(1). Accordingly,

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[5]The force of the Debtors' assurances that "KEIP Participants are not eligible for a KEIP award hereunder unless clear-cut performance hurdles are achieved," Employee Motion, ¶ 49, and that awards are triggered "only upon the satisfaction of specific performance milestones," Id. at ¶ 54, is undermined by the fact that those "clear-cut performance hurdles" are not identified in the Employee Motion.

[6]In Footnote 5 of the Employee Motion, the Debtors disclose that "certain aspects of the KEIP have not been finalized." Employee Motion, p.4, n.5. The Committee's approval of the KEIP "is subject to its review of the final terms of the KEIP." Id. Nowhere do the Debtors indicate which "aspects of the KEIP have not been finalized." Thus, the Employee Motion does not indicate that information as to the incentives is forthcoming to the Committee. Furthermore, the Debtors do not state that they intend to share any new "aspects of the KEIP" with anyone other than the Committee. See id.

the Court should conclude that the Debtor has failed to satisfy its burden under section 503(c)(1) and the "incentive" awards to insiders should not be approved at this time.

b. The Debtor Also Fails to Satisfy Section 503(c)(3)

Even if the Court finds that section 503(c)(1) does not apply, the Court may also consider whether the payments are permissible under section 503(c)(3). Dana II, 358 B.R. at 576. Section 503(c)(3) authorizes judicial discretion with respect to bonus plans motivated primarily by reasons other than retention. Id. It has been held that section 503(c)(3) reiterates the standards for assessing transactions outside the ordinary course of business under section 363, based on the business judgment of the debtor. Id.; but see In re Pilgrim's Pride Corp., 401 B.R. at 236 -37 (section 503(c)(3) sets a higher standard of review and should not be equated to the business judgement rule as applied under section 363; to do so would render 503(c)(3) redundant).

Section 503(c) is also "intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it." Pilgrims' Pride, 401 B.R. at 237.

Here, the Debtors have failed to demonstrate that the bonus plans are justified by the facts and circumstances of these cases. In fact, it is impossible for the Debtor to do so without disclosing the plans' metrics. The are essential to any determination as to whether the facts and circumstances of the cases justify the proposed bonuses which, as noted above, must be difficult to attain. Dana II, 358 B.R. at 583.

Although the Debtors explain that the KEIP participants are employees who "have shouldered additional responsibilities on account of the US and Cayman proceedings," or "[e]mployees managing or overseeing one or more specific Arcapita Group portfolio

companies," the Employee Motion does not explain how the Debtors made the determination include these participants. Employee Motion, ¶ 28. The Key Employees are not acting alone. The Debtors have retained – and has promised to pay -- several financial professionals to render advice concerning how the Debtors' businesses should be run, the value and disposition of its assets, its monthly reporting to the Bankruptcy Court. See ECF Doc. Nos. 123, 138, 241. The Employee Motion identifies no specific actions or services to be rendered by the Key Employees, either individually or as a group, that the retained professionals, such as Alvarez & Marsal, KPMG, and Rothschild, are not to perform. Although keeping the company operating as a going concern is a legitimate function of the Key Employees, the Employee Motion contains no evidence for the proposition that this function will not be fulfilled absent incentive or retention bonuses. The Employee Motion also contains no evidence that any or all of the Key Employees will be able to maximize a sale price (in the event the company is sold) or formulate a viable plan beyond the financial professionals' ability to achieve the same goal.

Further, the Employee Motion fails to set forth any basis to determine that it is the efforts of the Key Employees rather than the efforts of the financial professionals that warrants bonuses for the former. The Employee Motion fails to specify the number of personnel and the extent of the services to be rendered by these professionals, whose employees will be working to sell or reorganize the company. Given that these professionals stand to be paid handsomely for their services, it is difficult to determine from the Employee Motion what additional value the Key Employees will provide.

Finally, the Debtor has failed to meet their burden of demonstrating compliance with the following Dana II factors, 358 B.R. at 576-77, which Courts traditionally use when analyzing the

fitness of an executive bonus plan under the business judgment test:

1. No Relationship Between Effort and Outcome of the Chapter 11 Cases

As noted above, the Key Employees' bonuses are not contingent on a successful outcome of these cases. There is no provision in either the KEIP or the KERP that ties the proposed bonuses to any distribution to unsecured creditors or in a viable plan of reorganization. The payment of bonuses must be not only "difficult to reach," Dana II, 358 B.R. at 583, but also meaningful to the success of the cases. See Borders, 472 B.R. at 472, 474 (tying bonuses to size of distribution to general unsecured creditors factor in approving incentive plan).

2. The Bonuses May Discriminate Unfairly

As discussed above, the Employee Motion is silent as to how high the Debtors have set the bar in order for each of the Key Employees to earn their respective bonuses. The Debtors' non-disclosure in this regard raises the strong possibility that the bonuses discriminate unfairly. From the Employee Motion, it is not possible to ascertain how many or what percentage of the Key Employees will earn their bonuses when a specific corporate benchmark is achieved. However, because the Debtors declined to create "a general incentive program that links Employee compensation to overall corporate performance," id. at ¶ 28, it is clear that some Key Employees will make out better that others under the bonus plans.

The Debtors explain that some KEIP participants have had unspecified "additional responsibilities" thrust upon them because of the bankruptcy proceedings. Id. at ¶ 28. Other KEIP participants have been "managing or overseeing one or more specific Arcapita Group portfolio companies." Id. To avoid rewarding an employee who supervises an underperforming portfolio company, while the company as a whole performs well, the Debtors decided to

formulate "a KEIP plan which establishes individual metrics for each individual KEIP participant." Id. Thus, there can be no doubt that the bonuses discriminate.

Whether such discrimination is unfair depends on the nature of the "individual metrics." The Employee Motion, however, does not indicate what those individual metrics may be.[7] To date, the Court and the parties-in-interest have no idea whether the bonus plans treat individual employees fairly or in an unfairly discriminatory manner. Moreover, there is no analysis in the Employee Motion regarding the compensation earned by the Debtors' employees not covered by the bonus plans. Thus, there is no basis upon which the Court can determine how much more favorably the Key Employees who work for Arcapita are to be treated under the bonus programs than the Key Employees who work for the portfolio companies. However, it is clear that the bonus plans are designed so that the bonuses to the various Key Employees are not equal. Therefore, the proposed incentive bonuses may, indeed, unfairly discriminate.

3. No Proof of Industry Standards

The Debtors state that the cost of the KEIP "falls below the average for comparable programs. . . ." Id. at ¶ 66. This general statement, however, addresses the overall cost of the KEIP to the estates. It does not address whether the individual bonuses meet the industry standards, nor does it relate to the "individual metrics for each KEIP Participant." Id. at ¶ 28. Thus, the Employee Motion lacks specific information regarding applicable industry norms and what comparable executive agreements contain insofar as individual bonuses are concerned.

[7]The question of the individual metrics is separate from the issue of the amounts the employees are to receive under the bonus plans. As noted above, the Debtors seek to seal the amounts the employees are to receive under the KEIP and KERP.

Therefore, the Debtors fail to provide proof of the industry standard.[8]

4. The Key Employees Have Not Retained Independent Counsel

The Employee Motion is silent regarding whether the Key Employees had independent counsel in negotiating the bonus plans. Thus, there is no evidence that the Debtors were involved in any meaningful "negotiation" with the Key Employees regarding the bonus plans.[9]

Because the Debtors have failed to meet their burden, the bonus plans cannot be approved by the Court.

WHEREFORE, the United States Trustee respectfully requests that the Court deny the Sealing Motion and the Employee Motion and grant such other relief as the Court may deem just and proper.

Dated: New York, New York
June 20, 2012

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[8]Alvarez & Marsal, the Debtors' financial advisors, have concluded that the KEIP met the industry standard in terms of the KEIP's overall costs. See Employee Motion, ¶ 66. The Employee Motion, however, does not indicate that Alvarez & Marsal addressed the issue of the bonuses for the individual participants.

[9]Although the Debtors argue that "the KEIP is the product of substantial negotiation," Employee Motion, ¶ 66, the negotiators were the Debtors, the Committee, and their respective advisors. Id. The Employee Motion does not indicate that the Key Employees retained independent counsel to negotiate the terms of the KEIP with the Debtors and/or the Committee.