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

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	**Chapter 11**
ARCAPITA BANK B.S.C.(C), et al.,	:	**Case No. 12-11076 (SHL)**
Debtors.	:	**(Jointly Administered)**

STATEMENT OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER PURSUANT TO SECTIONS 363(B) AND 503(C) OF THE BANKRUPTCY CODE AND BANKRUPTCY RULE 9019 AUTHORIZING DEBTORS TO IMPLEMENT EMPLOYEE PROGRAMS AND GLOBAL SETTLEMENT OF CLAIMS

The Official Committee of Unsecured Creditors (the "Committee") of Arcapita Bank B.S.C.(c) ("Arcapita") and each of its affiliated debtors in possession (collectively, the "Debtors" and, together with the Debtors' non-Debtor subsidiaries, the "Arcapita Group") in the above-captioned chapter 11 cases (the "Chapter 11 Cases") hereby submits this statement in support (the "Statement") of *Debtors' Motion for an Order Pursuant to Sections 363(b) and 503(c) of the Bankruptcy Code and Bankruptcy Rule 9019 Authorizing Debtors to Implement*

Employee Programs and Global Settlement of Claims [Docket No. 205] (the "Employee Settlement Motion").[1]

STATEMENT

1. The Committee supports the relief requested in the Employee Settlement Motion. From the time of its appointment, the Committee recognized that the Debtors must engage in the difficult process of reducing their workforce. The Debtors and the Committee worked together in good faith to come to an agreement regarding the details of this undertaking. Based on efforts that have continued through the time of filing of this Statement, the Committee believes that the parties have reached a workable construct for this workforce reduction that appropriately safeguards the interests of the Debtors' stakeholders, while enhancing the value of the Debtors' estates for the benefit of unsecured creditors.

2. But the Employee Settlement Motion contemplates relief beyond a reduction in workforce. From the outset of their discussions regarding the framework for the Employee Settlement Motion, the Committee made clear that (a) the proposed reduction in force should be carefully structured such that additional, piecemeal reductions could be avoided; (b) it was inappropriate under the circumstances of these cases for the most senior executives of the Debtors to participate in the proposed retention or incentive programs; and (c) the Debtors should implement retention and incentive programs simultaneously with the reduction in force, to make it clear to employees that the Debtors intended a long-term right-sizing of the workforce, rather than short-term cost-cutting. The Debtors adopted each of these principles.

3. The final agreement between the Committee and the Debtors is reflected in the Employee Settlement Motion, as modified by the revised proposed order (the "Revised

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Employee Settlement Motion.

Proposed Order") that the Debtors will submit to the Court prior to the hearing. For the reasons set forth below, the Committee requests that the Court enter an order substantially in the form of the Revised Proposed Order.

I. Global Settlement

4. The Global Settlement is the aspect of the relief requested in the Employee Settlement Motion on which the Committee has most squarely focused. This focus is justified by the size of the Global Settlement, which could result in the forgiveness of $15.49 million in obligations owed to the Debtors by their employees under the IPP/IIP.[2] In return, the Debtors propose that for employees who agree to be bound by the Global Settlement, Notice and Severance Payments will be capped at four months' salary.

5. The Committee struggled with this proposal. First, such a program contemplates the Debtors forgiving valid obligations owing to them, in favor of "doubling down" on some of the same investments that contributed to the Debtors' need to seek chapter 11 protection. Second, the proposal permits employees to participate in the program at their option, so employees are likely to participate only if they believe the amount of their outstanding obligations is greater than the value of the equity interests they hold pursuant to the IPP/IIP.

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[2] Employee Settlement Motion ¶ 38. The Employee Settlement Motion notes that a number of the employees who owe Arcapita pursuant to the IPP/IIP actually owe Arcapita more than the "fair value 'mark' of the shares that would be returned to Arcapita Group via the Global Settlement." Id. While this is an important concept in understanding why the cancellation of employee loan obligations under the IPP/IIP in return for the employee's related shares is attractive to employees, the Debtors' quantification of these "Net Obligations" may not be entirely accurate. The Committee has been advised that upon the valuation of the Debtors' investments by KPMG that is currently in progress, the stated value of the Debtors' investment assets is likely to be lower than the net asset value attributed to such investment assets in the Debtors' most recent financial statements, which is the source used to determine the Net Obligations in the Employee Settlement Motion. The shares held by employees under the IPP/IIP are directly tied to these investment assets, so if the value of these investment assets falls, the Net Obligations will increase. Thus, the Committee believes it is likely that the Net Obligations of employees under the IPP/IIP is greater than the $358,000 set forth in the Employee Settlement Motion. See id.

6. The Committee also recognized the benefits that the Global Settlement provides to the Debtors' estates. For a number of employees, particularly those who are long-term, the limitation of Notice and Severance Payments to four months' salary will provide significant savings to the Debtors' estates. Additionally, the Debtors will receive equity interests in the portfolio companies from any employees who elect to participate in the Global Settlement. The Global Settlement also contemplates that, to the extent employees have received the 25% relief from any loan given to all employees with at least five years of service with the Arcapita Group, but such employees have not yet fully satisfied the related loans, then a *pro rata* portion of that 25% of the loan is treated as outstanding for the purpose of calculating the amount of shares the Debtors will take back as part of the Global Settlement.

7. Although the Committee believes that the employee obligations under the IPP/IIP are enforceable, the reality is that such enforcement could (a) involve substantial expense, (b) result in judgments on which the Debtors would have difficulty realizing (for instance, if the relevant employee has insufficient assets to satisfy the judgment), and (c) engender discontent among current employees, were the Debtors to take legal action against current or former employees under what was intended to be an incentive program. The Committee is also sensitive to the reality that the Debtors' employees are acutely interested in loan forgiveness, to the point that it may be damaging to the morale of continuing employees if they are not offered the same loan forgiveness as Terminated Employees.

8. The Committee negotiated several additional protections for the Debtors' estates, including that (a) to receive loan forgiveness, continuing employees electing to participate in the Global Settlement must remain employed with the Debtors for 120 days after entry of an order approving the Employee Settlement Motion; (b) the Debtors' seven most senior

executives will not be eligible to participate in any aspect of the relief; (c) the cap on notice and severance obligations at four months' salary applies to continuing employees who elect to participate in the Global Settlement should they be terminated without cause in the future, even after the Debtors' reorganization is effective; (d) the Global Settlement will be available to employees for a 120-day opt-in period after entry of an order approving the Employee Settlement Motion, by which time employees with outstanding loan obligations under the IPP/IIP must determine whether they will participate; and (e) no employees may receive loan forgiveness if they are at any time terminated for cause.

II. Payments to Employees Terminated Without Cause

9. The Committee and its advisors carefully considered the Notice and Severance Payments, Accrued Vacation Payments, Private Pension Payments, Expatriate Expense Payments, Accrued Bonus Claims, and proposed suspension of the SPP.[3] As the Debtors note, many of the payments are to be made on account of obligations that would give rise to administrative priority claims, so such payments do not deplete estate assets that would otherwise be available for unsecured creditors. Additionally, many of the Terminated Employees are located in foreign jurisdictions, where it may be difficult and costly to enforce the automatic stay, so failing to make payments on account of such prepetition obligations would run

[3] The Debtors propose to reduce all of these proposed payments to Terminated Employees by the amount of outstanding Employee Loans owed to the Arcapita Group by the respective Terminated Employees. Today, the Debtors informed the Committee's counsel that for a small number of Terminated Employees, the dollar amount of Employee Loans exceeds the aggregate dollar amount of Notice and Severance Payments, Accrued Vacation Payments, Private Pension Payments, and Expatriate Expense Payments otherwise proposed to be paid to such Terminated Employees. For these Terminated Employees, the Debtors propose to apply the respective outstanding obligations under Employee Loans to (a) reduce to zero any payments to which such Terminated Employees would otherwise be entitled under the relief requested as Notice and Severance Payments, Accrued Vacation Payments, Private Pension Payments, and/or Expatriate Expense Payments, and (b) forgive the remaining balance of the Employee Loans. The Committee has not had an opportunity to review this aspect of the relief requested in the Employee Settlement Motion and, therefore, has no opinion regarding the appropriateness of the forgiveness of the Employee Loans as described. The Committee reserves all rights with respect to this aspect of the relief requested in the Employee Settlement Motion.

the risk of litigation in such foreign jurisdictions by the relevant Terminated Employees seeking payment. Moreover, a number of the Terminated Employees are employed by non-Debtors, which do not enjoy all of the benefits of the automatic stay, so the non-Debtor employers generally would be required to make payments on account of prepetition obligations.

10. Perhaps most importantly, however, making these payments is a sign of good faith from the Debtors to all of their employees, whether terminated or retained. Ensuring fair treatment for employees who are terminated without cause demonstrates to the remaining employee population that the Debtors will be reasonable in their dealings as they continue to navigate their reorganization. The Committee supports these aspects of the program, which strike an appropriate balance between long-term cost savings from rationalizing the size of the Arcapita Group's workforce, and the fair treatment of continuing employees.

III. Key Employee Incentive Program

11. The Committee shares the Debtors' view that the strict standards of section 503(c)(1) of the Bankruptcy for the approval of payments to insiders, for the purpose of inducing them to remain in a debtor's employ, are not applicable to the approval of the Debtors' Key Employee Incentive Program (the "KEIP"). Section 503(c)(1) provides that "there shall neither be allowed, nor paid – (1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business . . . " 11 U.S.C. § 503(c)(1).

12. The Committee received the proposed triggers for payments to employees under the KEIP days prior to the filing of this Statement. The Committee is satisfied that the KEIP does not provide for retention payments governed by section 503(c)(1), but rather is incentivizing in nature, as it is intended to reward certain key employees based upon their

performance. See, e.g., In re Velo Holdings Inc., 2012 WL 2015870, at *5-7 (Bankr. S.D.N.Y. 2012) (holding that section 503(c)(1) did not apply to key employee incentive program that utilized revenue and EBITDA targets); In re Borders Group, Inc., 453 B.R. 459, 471-73 (Bankr. S.D.N.Y. 2011) (holding that section 503(c)(1) did not apply to key employee incentive program because, among other reasons, bonus triggers were tied to the achievement of particular financial milestones, and the program's goals were consistent with the policies underlying chapter 11). The KEIP is tied to the achievement of performance goals, such as reaching EBITDA targets for certain portfolio companies, completing a business plan and/or filing a chapter 11 plan of reorganization, and renegotiating certain financial covenants, which are specific to each eligible employee and must be met by specified dates. Accordingly, the KEIP is not the type of retention plan to which section 503(c)(1) applies.

13. In evaluating the merits of the proposed KEIP, the Committee considered how the effects of its implementation compared with the Committee's goals in the Chapter 11 Cases, such as increasing the speed with which the Debtors move toward a plan of reorganization, increasing the value of the portfolio companies, and streamlining the Debtors' operations. Ultimately, the Committee concluded that the final version of the KEIP, which includes certain Committee recommendations, is appropriately structured to achieve these goals.

14. One additional consideration is that the Debtors have very limited liquidity. On the petition date, the Debtors had approximately $147 million in cash. As of the end of June 2012, the Debtors are projected to retain only $82.2 million in bank accounts they control. Meanwhile, only relatively small amounts of cash are coming into the estates. See, e.g., *Fifth Interim Order (A) Authorizing Debtors to (I) Continue Use of Existing Cash Management System, Bank Accounts and Business Forms and (II) Continue Ordinary Course Intercompany*

Transactions; and (B) Granting an Extension of the Time to Comply with the Requirements of Section 345(b) of the Bankruptcy Code [Docket No. 198], Exh. A (projecting gross cash inflows for June 2012 at $250,000, compared with approximately $45.1 million in expenditures, including restructuring costs). In examining the merits of the KEIP (as well as the KERP), the Committee was extremely mindful of the Debtors' precarious cash position. The Committee is satisfied that the cost to the Debtors' estates of implementing the KEIP (approximately $3.2 million) is within the range of reasonableness for a business of the Debtors' size.

15. The Committee is comfortable with the KEIP Performance Goals. Because circumstances relevant to the KEIP Performance Goals may change over time, the Debtors agreed that if any foundational information provided to the Committee proves to have been inaccurate at the time it was provided, then the Debtors and the Committee will work together to ensure that any relevant KEIP Performance Goals are reset appropriately. Additionally, and for similar reasons, the Committee has agreed that, with the Committee's consent, the Debtors should be permitted to continue to modify the terms of the KEIP subsequent to entry of an order approving the Employee Settlement Motion. These procedures allow the Debtors and the Committee to craft appropriate terms for the KEIP, while still providing for sufficient oversight to ensure the maximization of value of the Debtors' estates. The Committee supports the proposed KEIP, with the above modifications.

IV. Key Employee Retention Program

16. To reduce employee attrition, it is appropriate in some cases to provide additional financial incentives (beyond ordinary compensation) to certain employees who are necessary to the Debtors' operations, in return for their commitment to remain with the Debtors' business for a specified period. At the same time, the Committee must be vigilant to ensure that such a retention program does not use estate funds to provide employees with an unearned

reward, transferring value from the estate to employees in return for something (remaining with the company) that the employees would have done anyway.

17. The Committee believes that the Key Employee Retention Program (the "KERP") proposed by the Debtors, which reflects modifications proposed by the Committee's advisors, represents the parties' best efforts to retain employees who are essential to the operations of the business, but who might otherwise be inclined to seek, and would likely be offered, employment elsewhere. Incentivizing such employees to remain with the Arcapita Group through the effective date of a plan of reorganization or liquidation could help to bridge a critical period for the Arcapita Group, when the potential for attrition could threaten to materially harm the Debtors' estates. Moreover, at a cost of approximately $2.0 million to the estate, the proposed KERP is reasonable in size. The Committee, therefore, supports the KERP.

18. Additionally, the Committee agrees with the Debtors that their proposed KERP does not implicate section 503(c)(1) of the Bankruptcy Code, because the KERP does not include any payments to "insiders."[4] The employees whom the Debtors propose to include in the KERP are not within the Debtors' senior management, and so do not qualify as "insiders" for whom retention payments are restricted under section 503(c)(1). See, e.g., Borders Group, Inc., 453 B.R. at 469 (finding that "critical employees" under the proposed key employee retention program lacked "decision-making authority akin to an executive" and "the authority to implement company policies" and, as such, they were not insiders under section 101(31)(B)).

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[4] Section 101(31)(B) of the Bankruptcy Code provides that, in the context of a corporation, the term "insider" includes a: "(i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer, or person in control of the debtor." 11 U.S.C. § 101(31)(B).

WHEREFORE, for the reasons stated herein, the Committee respectfully requests that the Court (i) grant the relief requested in the Employee Settlement Motion; (ii) enter an order substantially in the form of the Revised Proposed Order; and (iii) grant such other and further relief as it may deem just.

Dated: New York, New York
June 22, 2012

MILBANK, TWEED, HADLEY & McCLOY LLP

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