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Objection Deadline: May 20, 2009

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In re:	)	
	)	Chapter 11
ADAMAR OF NEW JERSEY, INC., and	)	
MANCHESTER MALL, INC.,	)	09-20711 (JHW)
	)	(Jointly Administered)
Debtors-in-Possession.	)	Oral Argument Requested

OBJECTION AND MEMORANDUM OF UAW IN OPPOSITION TO DEBTORS' MOTION FOR AN ORDER APPROVING KEY EMPLOYEE PAYMENTS AND GRANTING RELATED RELIEF

International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (the "UAW"), by its undersigned counsel, objects to Debtors' Motion For An Order Approving Key Employee Payments and Granting Related Relief (the "Motion"). The proposed payments to twenty-four insiders do not satisfy the requirements of Section 503 of the Code, which governs here.

INTRODUCTION AND BACKGROUND

The UAW and its Collective Bargaining Negotiations with the Debtor

1. Debtors Adamar of New Jersey, Inc. and Manchester Mall, Inc., (the "Debtors") own and operate a casino resort in Atlantic City, New Jersey, known as the Tropicana Casino and Resort - Atlantic City (the "Trop AC"). In December, 2007, retired New Jersey State Supreme Court Justice Gary S. Stein became active trustee of Adamar's stock and conservator of its assets.[1]

2. On September 7, 2007, the UAW was certified as the exclusive collective bargaining representative for Trop AC's dealers and slot technicians.[2] Upon information and belief, the UAW represents over 700 full and part-time dealers and 23 slot technicians.[3]

3. Since December 2007, the UAW and Justice Stein have been in negotiations to enter into their first collective bargaining agreement; during the negotiations, Justice Stein and his designees have indicated that they are not in a position to enter into an agreement with the UAW because Justice Stein is unwilling to commit the assets to long-term obligations while an asset sale is pending.

4. In March 2009, the same month Debtors were committing themselves to paying the insider executive bonuses that are the subject of this Motion,[4] Trop AC implemented

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[1] Motion at ¶ 7.

[2] The UAW does not believe the facts stated here relevant to the UAW's representation of Trop AC's workers, its negotiations with Justice Stein, and Trop AC's actions with regard to worker health benefits and potential layoffs are in dispute. If necessary, the UAW will establish any disputed facts at the hearing on the Motion.

[3] Debtors previously filed with the Court a motion for approval of a $200 million "stalking horse" credit bid Asset Purchase Agreement among the Debtors, Justice Stein, and certain other interested parties, along with proposed bidding procedures related to the Debtors' sale of substantially all their assets and the assumption of related executory contracts, unexpired leases, and collective bargaining agreements (the "Sale Motion")

unilateral changes to the health insurance benefits of UAW-represented employees, including: (i) a $300 increase in the annual deductible; (ii) increased co-payments for emergency room and hospital services; and (iii) 20% increases in weekly employee contribution costs. Trop AC has also suggested that it may lay off approximately seventy-five dealers in response to Trop AC's financial performance.

The Proposed Payments to Insiders

5. Debtors ask this Court for authority to make two types of payments to twenty-four insider executives, including Trop AC's President and Chief Operating Officer and its Chief Financial Officer, pursuant to fifteen Confidential Retention Bonus Agreements and nine Confidential Retention and Severance Agreements that were entered into in March 2009 (collectively, the "Agreements).[5]

6. In the first type of payment, each of the twenty-four insider executives will receive an Initial Retention Bonus — 75% of the total Retention Bonus — upon the occurrence of a "Closing Date," provided the employee remains employed with the Debtors on the Closing Date. These lump-sum payments total $866,250[6] and are due in the event that Debtors dispose of substantially all of their assets in a sale pursuant to Section 363(b) of the Bankruptcy Code, a confirmed plan of reorganization is effected, or the Debtors' cases are converted to a Chapter 7 liquidation or dismissed.[7]

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[4] Motion at ¶ 15.

[5] Motion at ¶ 22.

[6] Debtors have not submitted the Agreements, and the Motion states only that the retention bonuses are in "varying amounts depending on the Eligible Employee;" it does not further explain how Debtors calculated the amount of the retention bonuses. Motion at ¶ 19.

[7] Motion at ¶ 19(a).

7. The Agreements call for a second wave of payments, totaling $288,750 (the "Remaining Retention Bonuses") to occur on a date 120 days after one of the aforementioned events, or March fifteenth of the year following the occurrence of such an event, whichever is sooner. Payments will be due to any of the twenty-four insider executives who remain employed with the company at the time payment becomes due, and to any of the twenty-four insider executives whose employment is terminated without cause between the date the Initial Retention Bonuses become due and the date the Remaining Retention Bonuses are due.[8]

8. The second type of payment for which Debtors also seek authorization is payment of the entire sum of the Initial Retention Bonuses and the Remaining Retention Bonuses — $1,155,000 — in the event the Debtor's cases are dismissed or converted before one of the aforementioned events.[9]

9. Nowhere in the Motion do the Debtors suggest that the payments are dependent in any way upon the quality or effectiveness of the insider's performance. The Retention Bonuses are not tied to obtaining a sale price greater than the stalking horse credit bid connected to the Sale Motion, and are not dependent on attaining EBITDAR or cash flow targets, or any other performance goal. An insider must simply stay employed to get an Initial Retention Bonus and stay employed or be terminated without cause to get the Remaining Retention Bonus. If the cases are converted or dismissed, an insider must simply stay employed until that occurs to receive his or her <u>entire Retention Bonus</u>.

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[8] Motion at ¶ 19(b). Debtors do not now seek the Court's authorization to make these payments. Presumably they will return to seek such authorization if a Closing Date occurs.

[9] Motion at ¶ 22.

OBJECTION

10. As a result of the addition of Section 503(c) to the Bankruptcy Code with the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, § 331, 119 Stat. 23 (Apr. 20, 2005), retention payments cannot be made to insiders unless the Court expressly finds that specific requirements set forth in Sections 503(c)(1) are satisfied.

11. Here, Debtors make no attempt to argue that the requirements of Section 503(c)(1) are met. Rather, Debtors attempt to circumvent these requirements by claiming that the payments are incentive payments, rather than retention payments, which need only satisfy Section 503(c)(3). As explained below, the payments are, pure and simple, retention payments subject to the limitations of Section 503(c)(1). Moreover, even if Debtors could somehow show that Section 503(c)(1) does not apply, the payments would still be impermissible because they run afoul of Section 503(c)(3)'s provision restricting transfers outside the ordinary course of business.

Overview of Section 503(c)

12. Prior to the enactment of Section 503(c) of the Bankruptcy Code, which became effective October 17, 2005, the Bankruptcy Code did not have any provisions expressly governing retention or severance payments made to insiders after the filing of a bankruptcy petition. Instead, such programs generally were considered under Section 363(b), unless a heightened, less deferential standard was warranted under the circumstances.

13. Section 503(c) of the Bankruptcy Code strictly limits the payment of retention bonuses and severance payments to insiders, and also prohibits transfers outside the ordinary course of business unless justified by the facts and circumstances of the case. The enactment of Section 503(c) was a result of increasing public sentiment against the practice of

executives of bankrupt companies generously rewarding themselves during restructuring at the same time that rank-and-file workers were suffering tremendous economic blows as a result of the bankruptcy.[10]

14. Specifically, under Section 503(c)(1), a retention-type obligation incurred for the benefit of an insider, as defined by Section 101(31),[11] "shall neither be allowed, nor paid" absent findings by the court, based upon evidence in the record, that (1) the individual has a job offer at the same or greater rate of compensation, (2) the services provided by the individual are "essential to the survival of the business," and (3) the payments meet a strict monetary test.[12]

15. Section 503(c)(3) prohibits other transfers or obligations outside the ordinary course of business "not justified by the facts and circumstances of the case."[13]

16. Congress' purpose in enacting new Section 503(c) could not be more clear: key employee programs should be limited and based upon actual, demonstrable need rather than on speculation and largesse. The Section 503(c) provisions support rigorous scrutiny of Debtor's proposed employment agreements given Congress' clear intent that such obligations be strictly regulated, and not deferential and presumptive reliance on the Debtors' articulated rationale.

17. Because Section 503(c) clearly applies to Debtors, any proposed key employee retention programs or payments outside the ordinary course of business must be evaluated under that section.

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[10] *See generally In re U.S. Airways, Inc.*, 329 B.R. 793, 797 (Bankr. E.D. Va. 2005).

[11] 11 U.S.C. § 101(31).

[12] 11 U.S.C. § 503(c)(1).

[13] 11 U.S.C. § 503(c)(3).

The Retention Components of the Proposed
Agreements Are Prohibited by Section 503(c)(1)

18. Debtors' nomenclature aside, there can be no hiding that the proposed payments are retention payments to insiders and, thus, subject to Section 503(c)(1).

19. The retention nature of the payments is highlighted by Debtors' proffered reasons for entering into the proposed agreements. The Motion makes clear that the purpose of these payments is to prevent the executives from leaving Debtors during the restructuring process. For instance, the Motion states that President and Chief Operating Officer Mark Giannantonio's "continued commitment to the Debtors and their sale process is instrumental and will be ensured by way of his incentive bonus."[14] Indeed, Debtors attempt to justify the retention payments because the Debtors "require the full and active participation of each of the Eligible Employees during these Chapter 11 cases and cannot afford to lose them."[15] Debtors note that "several [of the insider executives] were offered jobs during 2007 and 2008 at other hotel gaming institutions though declined said offers in keeping with their commitment to the Debtors,"[16] and "Debtors and their estates cannot afford for the Eligible Employees to be distracted, resign, or worse yet, migrate to a competitive gaming institution."[17]

20. The law is clear that payments conditioned essentially and simply on disposing of assets or reorganizing a debtor, with no provisions to incentivize the maximization of the value of the estate, are retention payments subject to the requirements of Section 503(c)(1).[18] In *Dana I*, for example, the debtor moved for approval of compensation agreements

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[14] Motion at ¶ 16(a).

[15] Motion at ¶ 26.

[16] Motion at ¶ 26 n.6.

[17] Motion at ¶ 29.

[18] *In re Dana Corp.*, 351 B.R. 96, (Bankr. S.D.N.Y. 2006) ("*Dana I*").

for five insider executives. The agreement with the debtor's Chief Executive Officer included a payment in the event the debtor emerged from reorganization. The court held that "[w]ithout tying this portion of the bonus to anything other than staying with the company until the Effective Date, this Court cannot categorize a bonus of this size and form as an incentive bonus."[19] Here, as in *Dana I*, there is no provision of the Agreements that conditions payment on anything other than staying with the company until a Closing Date.

21. None of the cased cited by the Debtors supports their attempt to portray the payments as "Incentive Bonuses." For instance, Debtors pretend that the proposed payments are "sale-related"[20] just like the payments that were approved in *In re Nobex Corp*.[21] In fact, *Nobex* involved payments that, unlike here, were sale-price related. In *In re Nobex Corp*., the court stressed that "the structure of the sale-related incentive compensation . . . [did] not provide for incentive compensation to [the employees] unless the gross sale price achieved exceed[ed] the proposed stalking horse bid" to conclude the payments were not a retention bonus, but rather a genuine attempt "to achieve a sale at a price higher than the $3.5 million amount of the proposed stalking horse bid."[22]

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[19] *Id*. at 102.

[20] Motion at ¶ 35.

[21] 2006 WL 4063024 (D. Del. Jan. 19, 2006).

[22] *Id*. at *2-3. *See also In re Global Home Prods. LLC*, 369 B.R. 778, 780-81 (Bankr. D. Del. 2007) (approving program where payment conditioned on achievement of EBITDAR and cash flow objectives); *In re Dana Corp.*, 358 B.R. 567, 574, 581 (S.D.N.Y. 2006) ("*Dana II*") (approving plan conditioning payment upon achievement of EBITDAR targets and emphasizing that it had "*no guaranteed payments* to the CEO or senior executives") (emphasis in original); *In re Calpine Corp.*, Case No. 05-60200 (BRL), Order Authorizing the Implementation of the Calpine Incentive Program (Bankr. S.D.N.Y. May 15, 2006) (approving plan conditioning payment on meeting cash metrics and specified performance goals and explicitly excluding insiders from payments based on risk of leaving company).

22. Here there is no suggestion whatsoever that the Retention Bonuses are at all related to maximization of the sale price of Debtors' assets. Where the *Nobex* court approved a detailed "pay for performance" incentive structure,[23] Debtors seek approval of simple "pay to stay" bonuses: retention bonuses. Debtors put it plainly: "the Debtors developed the Initial Incentive Bonuses to entice the Eligible Employees to remain in the Debtors' employ," not to achieve any specific performance goals or increase the value of the Estate.[24]

23. Because Section 503(c)(1) governs the instant Motion and Debtors present no facts that the proposed payments satisfy the statutory requirements, the proposed payments are prohibited.

The Proposed Payments Would Not Survive Scrutiny Under Section 503(c)(3)

24. Even if the proposed payments were not subject to Section 503(c)(1), the payments would nonetheless be impermissible because the proposed transfers, outside the ordinary course of business, are not justifiable by the facts and circumstances as required by Section 503(c)(3).

25. As a threshold matter, and contrary to Debtors' assertion, they are not entitled to a presumption regarding their business judgment. Congress enacted the new requirements under Section 503 rather than Section 363(b), to ensure that judicial review of executive compensation was commensurate with scrutiny of other requests for payment of administrative expenses. Not one of the "sound business purpose" cases cited by Debtors was actually filed after BAPCA was enacted.[25]

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[23] *Nobex*, 2006 WL 4063024, at *3.

[24] Motion at ¶ 26 (emphasis added).

[25] Motion at ¶ 28.

26. Instead, the proposed bonuses should be subject to "rigorous scrutiny," and reviewed for "inherent fairness" and good faith,[26] independent of Debtors' own analysis.[27]

27. Even if the Court were to apply the business judgment standard to the Retention Payments, Debtors would not meet it. The court in *Dana II* set forth the factors that should be considered in evaluating motions for enhanced compensation under Section 503(c)(3):

> "[1] Is there a reasonable relationship between the plan proposed and the results to be obtained. . . in the case of a performance incentive, *is the plan calculated to achieve the desired performance*?;
>
> [2] Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?;
>
> [3] Is the scope of the plan fair and reasonable. . .?;
>
> [4] Is the plan consistent with industry standards?;
>
> [5] What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized. . . .; [and]
>
> [6] Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the compensation?"[28]

28. Debtors have presented nothing indicating that there was any due diligence in connection with the Agreements, nothing to suggest that the Agreements are consistent with industry standards, and nothing indicating that they received independent counsel in formulating the Agreements. Debtors assert that the bonuses are "geared specifically to incentivize and reward the Eligible Employees to devote their energies, efforts, knowledge, and

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[26] *See Pepper v. Litton*, 308 U.S. 295, 306 (1939). To the extent *Dana II* and the other cases cited by Debtors suggest that increases to executive compensation in bankruptcy need meet only a low bar to pass legal muster, they run contrary to Congress' intent in enacting BAPCA.

[27] *See, e.g.,, In re Regensteiner Printing Co.*, 122 B.R. 323 (N.D. Ill 1990) (rejecting the business judgment test for executive compensation program and requiring proponents to prove fairness to the estate and to creditors).

[28] *Dana II*, 358 B.R. at 576-77 (emphasis in original).

creativity toward achieving the required sale of Debtors' assets"[29] but, as noted above, there is nothing in the plan that rewards the executive insiders based on achieving a high sale price, the speed of the sale, or any other metric that would indicate that their efforts had been successful and valuable to the process. The motion seeks simply to reward executives for completing the sale or any other significant event in the bankruptcy process. Tellingly, the insider executives are to receive payment <u>even if there is no sale and the cases are converted to Chapter 7 liquidation or dismissed</u>. This undermines any suggestion that the purpose of these bonuses is to enhance the value of the Estate and makes clear that it is simply a prohibited attempt by the insiders to "line[] their own pockets" without regard for how so doing will affect other employees or assist a successful bankruptcy outcome.[30]

29. In addition, the proposed payments would commit the Estate to costly completion payments barely one month into the bankruptcy case. So-called completion bonuses should be considered in the context of plan negotiation or Section 363 sale approval when actual outcomes and the recipients' contributions can be evaluated. For example, in *In re America West Airlines*,[31] the court approved confirmation bonuses only after considering the history of the case and the recipients' contributions to the reorganization. It is far too early in the bankruptcy process to commit Debtors to rewarding insider executives for nothing more than seeing the process to completion.

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[29] Motion at ¶ 30.

[30] *Dana II*, 358 B.R. at 575.

[31] 171 B.R. 674, 677-78 (Bankr. D. Ariz. 1994). *See also U.S. Airways*, 329 B.R. at 800-01 (declining to approve severance payments for executives in advance of confirmation so as to avoid committing the estate to costly severance arrangements prior to anticipated merger with America West, and finding that the severance liabilities could preclude or limit consideration of alternative plans).

30. Moreover, Debtors fail to take into account the effects of implementing a generous bonus program for a select group of the workforce. At a time when Trop AC's unionized workers have been told that a collective bargaining agreement cannot be committed to because Justice Stein is unwilling to commit the assets to long-term obligations, the Motion proposes to commit the Estate to issuing rewards to twenty-four executives, at the Estate's expense, with no regard at all for whether the executives do an adequate job in maximizing the value of the Estate in the proposed sale or in any other potential resolution of the bankruptcy proceedings. Further, Debtors seek to issue generous payments to top executives while demanding that UAW workers bear a greater burden of their health-care costs, and even threaten that some of the workers may lose their jobs. Debtors attempt to justify the Retention Bonuses on the basis of their need to maintain employee morale,[32] while ignoring the fact that paying generous bonuses to executives while demanding sacrifices from rank-and-file workers does not bolster morale but undermines it.

31. In addition, Debtors will be critically dependent on the participation of the UAW and the union-represented employees in gaining the maximum possible benefit of a Section 363 sale or a successful reorganization. As Debtors continue to negotiate with the UAW to reach a satisfactory agreement, UAW's already challenging task will be made even more difficult if employees view the process as tainted by large awards for a select few while they attempt to negotiate a contract that meets their needs and is economically feasible for Trop AC.[33]

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[32] Motion at ¶¶ 29-30.

[33] *See U.S. Airways*, 329 B.R. at 799 (noting that the "most compelling" objection to bonus and severance program is employees' objection "that it represents a betrayal of the principle of 'shared sacrifice'").

Union support in a difficult bankruptcy is an essential element of a successful emergence, a factor that is directly pertinent to consideration of the proposed compensation arrangement.[34]

32. Because of the potential for damage to employee morale the Motion should be denied.

<u>The Retention Bonuses Are Improper Even if Paid from Cash Collateral</u>

33. Debtors unabashedly ask the Court to authorize payment of the Retention Bonuses in full if the cases are converted to Chapter 7 or dismissed.[35] The Court should neither allow Debtors to reward these executives for failing nor permit a distribution that violates the Bankruptcy Code's priority rule.[36]

34. Debtors seek to avoid the priority rule by arguing that the rule is limited to the plan confirmation context,[37] and that a secured creditor may give up a portion of its lien proceeds for the benefit of junior creditors, citing *In re World Health Alternatives*[38] and *In re TSIC, Inc.*,[39] both of which relied upon a pre-BAPCA case, *In re SPM Manufacturing Corp.*[40]

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[34] *See id.* at 799-800 (declining to approve a severance program in advance of plan confirmation, and applying a "fair and reasonable" test requiring "careful consideration of" unions' objections); *see also In re Geneva Steel Co*., 236 B.R. 770, 773-74 (Bankr. D. Utah 1999) (declining to approve incentive and severance benefits because company had proposed the program without consulting with the union, and noting evidence that the program would jeopardize union support for reorganization).

[35] Motion at ¶ 39.

[36] *In re Armstrong World Indus., Inc.*, 432 F.3d 507, 514 (3rd Cir. 2005) ("Creditors must also be guided by the statutory prohibitions of the absolute priority rule [in distributing bankruptcy proceeds]").

[37] Motion at ¶¶ 42-43.

[38] 344 B.R. 291 (Bankr. D. Del. 2006).

[39] 393 B.R. 71 (Bankr. D. Del. 2008).

[40] 984 F.2d 1305 (1st Cir. 1993).

World Health Alternatives and *TSIC* do not support Debtors' argument, however. Both of them involved settlements where distributions were made to unsecured creditors.[41]

35. Here, in sharp contrast, Debtors wish to carve out proceeds for the purpose of paying insider executives, not creditors, and the Motion must therefore be considered in light of BAPCA. As one court has noted "[t]he amendment made to 11 U.S.C. § 503(c) by BAPCA, which severely limits the payments allowed to be made to retain key employees or management, furthers the likelihood that this type of arrangement [where a senior lender contributes to a management incentive plan] would not be approved today."[42] Thus, the holdings of *World Health Alternatives* and *TSIC* should not be expanded so as to authorize payments to individuals who are not creditors and do not have any claim whatsoever to the Estate, especially when doing so would violate the purposes behind Section 503(c).[43]

36. Further, in both *World Health Alternatives* and *TSIC* the carve-outs facilitated the bankruptcy process.[44] Here, Debtors seek the exact opposite: authorization of retention bonus payments in the event of Chapter 7 conversion or dismissal, which will result only if reorganization fails or a Section 363 sale is not successful. Unlike in *World Health Alternatives* and *TSIC*, where the carve-outs were a necessary step to a successful Chapter 11 outcome, Debtors seek authorization to pay unearned bonuses to executives who will have failed

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[41] *See World Health Alternatives*, 344 B.R. at 294; *TSIC*, 393 B.R. at 74.

[42] *See In re OCA, Inc.*, 375 B.R. 72, 86 n.63 (Bankr. E. D. La. 2006).

[43] Nor does the other case cited by Debtors, which predated BAPCA and had nothing to do with executive bonuses, support their argument. *See In re Hotel Syracuse, Inc.*, 275 B.R. 679 (Bankr. N.D.N.Y. 2002) (approving carve-out that paid fees for debtors' counsel but not for unsecured creditors committee's counsel).

[44] *See World Health Alternatives*, 344 B.R. at 294 ("In this case, the settlement represents global peace among the Debtors, the Committee, and the [provider of debtor-in-possession financing]"); *TSIC*, 393 B.R. at 79 ("The settlement paved the way for the mutual cooperation needed to bring about the Sale.").

to bring about a beneficial result for the Estate. The insider executives should not be rewarded for failure, and the Court should deny Debtors' Motion.

Conclusion

For the foregoing reasons, the Debtors' Motion should be denied.

Dated: May 20, 2009

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