IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
THQ, INC., *et al.*,	:	Case No. 12-13998 (MFW)
Debtors.	:	Jointly Administered
	:	**Hearing Date and Time: January 4, 2013 at 10:30 a.m. ET**
	:	**Objection Deadline: January 2, 2013 at 4:00 p.m. ET**

OBJECTION TO (A) DEBTORS' MOTION FOR FINAL ORDER (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN EMPLOYEE BENEFITS AND PROGRAMS AND (II) AUTHORIZING AND DIRECTING APPLICABLE BANKS AND OTHER FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS, AND (B) DEBTORS' MOTION FOR ORDER APPROVING THE DEBTORS' KEY EMPLOYEE RETENTION PLAN

The Ad Hoc Committee of Convertible Noteholders (the "Convertible Committee"),[1] consisting of holders of 5.00% Convertible Senior Notes Due 2014 (the "Convertible Notes") issued by THQ Inc. ("THQ" and, together with its affiliated debtors, the "Debtors"),[2] for its Objection to (A) Debtors' Motion For Final Order (I) Authorizing the Debtors to Pay Certain Employee Obligations and Maintain Employee Benefits and Programs and (II) Authorizing and Directing Applicable Banks and Other Financial Institutions to Honor and Process Checks and

[1] The undersigned represented a pre-petition ad hoc committee of holders of Convertible Notes. The post-petition Convertible Committee is in "formation" given that a significant portion of the Convertible Notes have traded since the Petition Date. The current members of the Convertible Committee are: (i) Silverback Asset Management, LLC; (ii) Third Avenue Focused Credit Fund; and (iii) Wolverine Flagship Fund Trading Limited. The present members of the Convertible Committee collectively hold, in the aggregate, approximately $41 million, or 41%, of original principal amount of the Convertible Notes. Holders of Convertible Notes are *pari passu* with general unsecured trade claims. Certain holders of Convertible Notes will also seek membership on the official committee of unsecured creditors (the "Official Committee") in these cases, which is scheduled to be appointed on January 3, 2013. Andrews Kurth LLP intends on seeking to be selected as counsel to the Official Committee, given that the Convertible Notes and other general unsecured claims are *pari passu* and aligned.

[2] The Debtors in these chapter 11 cases are: (i) THQ Inc.; (ii) THQ Digital Studios Phoenix, Inc.; (iii) THQ Wireless, Inc.; (iv) Volition, Inc.; and (v) Vigil Games, Inc.

12133981301020000000000005

Transfers Related to Such Obligations [Docket No. 9] (the "Employee Benefits Motion"), and (B) Debtors' Motion for Order Approving the Debtors' Key Employee Retention Plan [Docket No. 18] (the "KERP Motion" and, together with the Employee Benefits Motion, the "Employee Retention Motions"), respectfully represent:

INTRODUCTION

1. In the Employee Retention Motions, the Debtors seek this Court's approval (i) to pay to their employees and other individuals (including, potentially, insiders) sums incurred pre-petition under bonus and benefit plans that the Debtors acknowledge are "retentive" in nature in amounts vastly in excess of the maximum amount allowed under Section 507(a)(4) of the Bankruptcy Code, and (ii) to institute a post-petition "key employee retention plan" that, among other things, would include significant payments to employees of non-Debtor foreign subsidiaries of THQ.

2. There is no justification for approval of the Employee Retention Motions under the facts and circumstances of these cases. The Debtors have proposed a "fast-track" sale of their business to Clearlake that would provide a net recovery to the Debtors' general unsecured creditors in an estimated range of 1-3%, at best. Moreover, although the Debtors appear determined to ensure that Clearlake is the successful bidder and that the Debtors' business is sold "as a whole" to Clearlake, it is unknown at this time whether Clearlake will be the ultimate purchaser of the Debtors' assets and whether the Debtors' assets will be sold in whole or in part. It would be entirely inappropriate to saddle the Debtors' estates with the administrative liabilities that they would incur if the Employee Retention Motions are granted when it is unclear how the ultimate purchaser of the Debtors' various assets will treat such employees and whether the Debtors' business will continue as a "going concern."

3. At this time, approval of the Employee Retention Motions is neither critical nor justified under the facts and circumstances of these cases and, therefore, they must be denied.

BACKGROUND

I. COMPANY OVERVIEW

4. The Debtors develop and publish "video games" for various game consoles, personal computers, wireless devices and the internet. The Debtors' game portfolio includes action, adventure, fighting, role-playing, simulation, sports and strategy games. The Debtors market and distribute these games to mass merchandisers, consumer stores, discount warehouses and other national retail stores, as well as through the internet, throughout the United States and internationally.

5. Although these cases were just commenced and no discovery has taken place, it appears that the Debtors' most valuable asset is its intellectual property and the goodwill related thereto. Several of the Debtors' most popular games, including such critically acclaimed and extremely popular titles as *Saints Row*, *Darksiders* and *Company of Heroes*, are based on intellectual property that is wholly-owned by the Debtors and developed by their internal studios. The Debtors also have a number of game titles, including the *Metro* and *Homefront* titles, that are original to the Debtors but are developed by third party, external developers. Finally, the Debtors also develop and distribute several games pursuant to exclusive intellectual property licenses from third parties, such as *World Wrestling Entertainment* and *South Park*.

6. The Debtors operate their business globally through various domestic and foreign subsidiaries and studios. Generally speaking, upon information and belief, THQ, Inc. and/or its domestic subsidiaries own THQ's intellectual property and are party to THQ's valuable intellectual property licenses. THQ's foreign subsidiaries market and distribute THQ's games to

direct-to-retail customers and through distributors to over 80 territories outside of the U.S. Upon information and belief, cash generated by THQ's foreign operations is held by THQ's foreign subsidiaries and "upstreamed" to THQ, Inc. (such subsidiaries' ultimate parent entity) (by means of intercompany loans rather than corporate dividends).

II. THE DEBTORS' BANKRUPTCY CASES AND THE PROPOSED CLEARLAKE SALE

7. On December 19, 2012 (the "Petition Date"), each of the Debtors filed with this Court a petition for relief under Chapter 11 of the Bankruptcy Code. On the Petition Date, among other things, the Debtors also filed (i) a motion seeking expedited approval of a sale of substantially all of their assets to Clearlake and bidding procedures in connection therewith (the "Sale and Bidding Procedures Motion") and (ii) the Employee Retention Motions.

8. Attached to the Sale and Bidding Procedures Motion was the Debtors' proposed asset purchase agreement with Clearlake (the "Clearlake APA"). Under the terms of the Clearlake APA, Clearlake would purchase "all or substantially all" of the Debtors' assets (i.e., the Debtors' business "as a whole") for an aggregate purchase price valued, by the Debtors, at approximately $60,650,000, payable in the form of: (i) cash in the amount required to satisfy all outstanding secured debt at closing (estimated to be $29,000,000); (ii) cash in the amount of $6,650,000; (iii) the assumption of the Assumed Liabilities set forth in the Clearlake APA (estimated to be $15,000,000); and (iv) an unsecured promissory note in the original principal amount of $10 million, due 2020 and with an interest rate of 2%, to be issued to the Debtors' unsecured creditors. Based upon a net present value calculation, the unsecured note would provide an estimated range of 1-3% recovery to the Debtors' unsecured creditors.

9. Under the Clearlake APA, Clearlake is not required to close the sale unless the Court approves the Bidding Procedures. The Bidding Procedures, however, contain numerous

provisions that would chill competitive bidding and appear intended to ensure that the Debtors' deal with Clearlake is consummated on the "fast track," including, among other things, (i) an expedited timeline that would require bidders to submit bids and attend an Auction within five (5) days following the hearing on the Bidding Procedures Motion, (ii) a requirement that all bids must be for "all or substantially all" of the Debtors' assets (and that the Debtors may refuse to entertain any bids on a "title-by-title" or "piecemeal" basis), and (iii) procedures that allow the Debtors to withhold information from potential bidders and otherwise determine which bidders may submit bids and attend the auction.

10. In the Employee Benefits Motion, the Debtors seek authority, among other things, (i) to pay to their employees and contractors pre-petition wages up to an aggregate amount of $975,000, (ii) to pay to eligible participants pre-petition amounts owed under a Quarterly Sales Bonus Plan up to an aggregate amount of $75,000, (iii) to pay to eligible participants pre-petition amounts owed under an Outstanding Profit Sharing Bonus Plan up to an aggregate amount of $1.4 million, (iv) to pay to eligible employees and contractors reimbursement for pre-petition amounts incurred by such parties for business expenses up to an aggregate amount of $10,000, (v) to pay to eligible participants pre-petition amounts owed under various benefit plans, including Vacation and PTO.

11. The Debtors request approval to pay the amounts set forth above, regardless of whether doing so would result in payments in excess of $11,725 for individual employees and other participants. In fact, the Debtors expressly acknowledge that a number of employees and/or participants will receive payments in excess of the statutory cap. *See, e.g.*, Employee Benefits Motion, ¶¶ 21, 32, 36. It is impossible to tell, however, the extent of such excess or the terms of such payments because the Debtors have not provided a list or schedule of the individuals set to

receive the payments or the amounts any such individuals are to receive. The Debtors also acknowledge throughout the Employee Benefits Motion that the relief they seek is primarily "retentive" in nature. *See, e.g.*, Employee Benefits Motion, ¶¶ 10, 21, 37, 71. Moreover, in the Employee Benefits Motion, the Debtors have not indicated whether any payments will be made to "insiders" within the meaning of section 101(31) the Bankruptcy.

12. In addition to the Employee Benefits Motion, the Debtors filed the KERP Motion, seeking this Court's approval to implement a "key employee retention plan." In the KERP Motion, the Debtors request authority, among other things, to pay an aggregate of $475,000 to eligible participants employed by THQ and certain of its subsidiaries, including an aggregate of $167,000 to employees of two (2) foreign subsidiaries that are not Debtors in these cases.[3] Although the Debtors allege in the KERP Motion that the individuals that would receive payments under the Key Employee Retention Plan are not "insiders" within the meaning of section 101(31) of the Bankruptcy Code, the Debtors did not provide a list or schedule of the individuals set to receive the payments or the amounts any such individuals are to receive.

13. On December 20, 2012, the Court held a hearing on the Debtors' first day motions. At the first day hearing, the Debtors and Clearlake asked this Court to schedule a final hearing on the Bidding Procedures and the Employee Benefits Motion during the holiday week of December 24, 2012. Notwithstanding the Debtors' and Clearlake's requests, this Court scheduled a hearing on the Bidding Procedures and the Employee Benefits Motion for January 4, 2013. This Court also scheduled the hearing on the KERP Motion for January 4, 2013. At the

[3] Certain of the Debtors' foreign subsidiaries are holding approximately $20 million of cash that was generated by or on behalf of THQ. To the extent these foreign subsidiaries are the same entities as the subsidiaries whose employees will receive payments under the Debtors' proposed "key employee retention plan," such subsidiaries could directly make any such payments, if necessary.

first day hearing, the United States Trustee announced that the formation meeting for the Official Committee of Unsecured Creditors would take place on January 3, 2013.

ARGUMENT AND AUTHORITY

I. Governing Law

14. Section 507(a)(4)(A) of the Bankruptcy Code provides that pre-petition claims not to exceed $11,725 per employee may be entitled to priority status for "wages, salaries, or commission, including vacation, severance, and sick leave pay" earned within 180 days of the Petition Date. 11. U.S.C. § 507(a)(4)(A). To the extent any such claims exceed the statutory cap set in 507(a)(4)(A) of the Bankruptcy Code or were incurred prior to 180 days before the Petition Date, they are not entitled to administrative or priority status and are *pari passu* with other general unsecured claims.

15. Although courts have acknowledged that payment of a debtor's prepetition general unsecured debt other than pursuant to a plan may be permitted, such payment may be made "only under extraordinary circumstances." *See, e.g., In re CoServ, LLC*, 273 B.R. 487, 491 (Bankr. N.D. Tex. 2002) at 491. The *CoServ* court developed the following test for determining whether a court should allow payment of a pre-petition general unsecured claim:

> The debtor must show three elements are present. First, it must be critical that the debtor deal with the claimant. Second, unless it deals with the claimant, the debtor risks the probability of harm, or, alternatively, loss of economic advantage to the estate or the debtor's going concern value, which is disproportionate to the amount of the claimant's prepetition claim. Third, there is no practical or legal alternative by which the debtor can deal with the claimant other than by payment of the claim.

Id. at 498.

16. Other courts have expressed the requirement necessary for payment of a pre-petition debt in similar ways - - the fundamental theme of which is that payment must be critical or necessary. *See, e.g., In re Just for Feet, Inc.*, 242 B.R. 821 (D. Del. 1999) (holding that payment of pre-petition claims may only be permitted when "critical to the debtor's reorganization" and "deemed necessary to the survival of a debtor in a chapter 11 reorganization."); *In re NVR L.P.*, 147 B.R. 126, 127 (Bankr. E.D. Va. 1992) (holding that a court may permit pre-payment of a pre-petition claim "when essential to the continued operation of the Debtors.").

17. Section 503(c) of the Bankruptcy Code was enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA") in an effort to limit the scope of "key employee retention plans" and other programs or plans providing incentives to management and employees of a debtor as a means of inducing such management and employees to remain employed by the debtor. *7 COLLIER ON BANKRUPTCY* ¶503.17[1], p. 503-101. Section 503(c) was specifically intended to limit a debtor's ability to favor insiders over the interests of the estate in a chapter 11 case. *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 234 (Bankr. N.D. Tex. 2009). The provisions of section 503(c) apply both to the adoption of retention plans and agreements post-petition as well as payments made under plans and agreements entered into pre-petition.

18. Section 503(c)(1) of the Bankruptcy Code limits transfers 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, unless a strict three part standard is met. First, the transfer or obligation must be necessary to retain the insider because the insider has a "bona fide" job offer from another business at the same or a greater rate of compensation. 11 U.S.C. §

503(c)(1)(A). An offer from the successor to the debtor or a purchaser of the debtor's stock or assets is not sufficient to satisfy this prong of the standard. *See In re Fieldstone Mortgage Corp.*, 427 B.R. 357 (Bankr. D. Md. 2010). Second, the debtor must show that continued employment by the insider is necessary for the business to survive. *7 COLLIER ON BANKRUPTCY* ¶503.17[2], p. 503-104. Third, the amount of the transfer or obligation cannot be greater than ten (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 incurred. *See* 11 U.S.C. § 503(c)(1)(C). If no such similar transfers were made or obligations incurred regarding nonmanagement employees during such calendar year, the amount of the transfer or obligation cannot be greater than 25 percent (25%) of the amount of any similar transfer made or obligation incurred for the benefit of such insider for any purpose during the previous calendar year. *Id*. The test under section 503(c)(1) is very strict and many courts have denied plans and other post-petition payments to be made to insiders when the primary purpose is retention. *See, e.g., In re Dana Corporation*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) ("If it looks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP)").

19. Section 503(c)(3) of the Bankruptcy Code serves as a "catch all" provision that prohibits administrative expense status to any payment or obligation (including those of management and employees) that is both outside the ordinary course of business and not "justified by the facts and circumstances of the case." 11 U.S.C. § 503(c)(3); *7 COLLIER ON BANKRUPTCY* ¶503.17[4], p. 503-107. Section 503(c)(3) applies regardless of whether the person to be compensated is an insider of the debtor. *In re Borders*, 2011 WL 1563633, at *8-10.

20. Courts have held that the standard for approval of agreements under section 503(c)(3) is higher than the bar set by the business judgment test. *See e.g., In re Dura Auto Sys.,*

Inc., Case No. 06–11202, Docket No. 1369 (Bankr. D. Del. June 29, 2007); *In re Supplements LT, Inc*., Case No. 08–10446 (KJC), Docket No. 227 (Bankr. D. Del. Apr. 14, 2008)*In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236-37 (Bankr. N.D. Tex. 2009); *In re CEP Holdings, LLC*, 2006 Bankr. LEXIS 3305, at *8-9 (Bankr. N.D. Ohio Nov. 28, 2006). In *Pilgrim's Pride*, the court laid out the following standard and the reasoning behind adopting it:

> The court concludes that section 503(c)(3) is 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. *The court reads this requirement as meaning that the court must make its own determination that the transaction will serve the interests of creditors and the debtor's estate.*

401 B.R., at 236-37 (emphasis added).

21. Approval under section 503(c)(3) is dependent upon the particular, often detailed, terms of the payment or plan and the evidence presented to support them. In *In re Global Home Products, LLC*, this court recognized several factors that a court should consider in determining whether a compensation proposal should be approved under section 503(c)(3), including the following:

- The relationship between the plan and the results sought to be obtained. Is the plan calculated to achieve the desired performance?
- Is the cost of the plan reasonable in relation to the value of the debtor's assets its liabilities, and its earnings potential?
- Is the scope of the plan fair and reasonable or does it discriminate unfairly in favor of certain employees?
- Is the proposal consistent with the industry standards?
- What due diligence did the debtor undertake in determining the need for the plan and determining which key employees needed to be incentivized?
- Did the debtor receive independent counsel in performing due diligence and crafting the compensation plan?

369 B.R. 778, 785-86 (Bankr. D. Del. 2007) (citing *In re Dana Corporation (Dana II)*, B.R. 567, 584 (Bankr. S.D.N.Y. 2006)).

II. The Employee Retention Motions Should Not Be Approved

22. The Convertible Committee does not object to the Debtors' request in the Employee Benefits Motion to pay pre-petition wages to their employees up to the statutory limit of $11,725. The relief that the Debtors seek in the Employee Benefits Motion, however, vastly exceeds this limited issue. As noted above, the Debtors seek authority, among other things, to pay to employees and eligible participants amounts up to $1.475 million on account of pre-petition bonus plans and to honor various pre-petition benefits programs, including vacation and paid time off, in amounts up to $500,000.

23. The Debtors expressly acknowledge that granting the relief sought in the Employee Benefits Motion would result in payments in excess of the $11,725 cap set forth in section 507(a)(4) of the Bankruptcy Code's to a significant number of individual employees and other participants. *See, e.g.,* Employee Benefits Motion, ¶¶ 21, 32, 36. Moreover, the Debtors have not disclosed which individuals will receive payments pursuant to the Employee Benefit Motion or provided any detail with respect to how much particular individuals will be receiving in excess of the statutory threshold. The Debtors have also acknowledged that the payments to be made under the Employee Benefits Motion are primarily designed to retain the Debtors' personnel. *See* Employee Benefits Motion, ¶¶ 10, 21, 37, 71. Additionally, the Debtors have not alleged or shown that the payments they seek to make pursuant to the Employee Benefits Motion will only be made to non-insiders.

24. The relief the Debtors seek in the Employee Benefits Motion is completely unjustified and unnecessary, at this time, under the present circumstances. The Debtors have proposed an expedited sale of all of their assets (i.e., a sale of their business "as a whole") to Clearlake. Although the Debtors have sought approval of bidding procedures in connection with

such sale that would effectively prohibit prospective bidders from bidding for less than all of the Debtors' assets (i.e., bidding on a "piecemeal" basis), such bidding procedures have not been (and the Convertible Committee believes that they cannot be) approved. Approval of the pre-petition retention bonus plans at this time would not make any sense in the context of a sale of the Debtors' assets on a "title-by-title" or "piecemeal" basis.

25. Although the Debtors appear intent on ensuring that Clearlake is the successful purchaser of the Debtors' assets, it is unknown at this time whom the ultimate purchaser of the Debtors' assets will be or how the bidding and auction process will play out. Although Clearlake has apparently agreed to assume the obligations under the bonus plans, if Clearlake is not the ultimate purchaser of the Debtors' assets (or if the Debtors' assets are sold on a "piecemeal" basis), there is no guarantee that the ultimate purchaser or purchasers will likewise agree to assume such liabilities. The Debtors should not be saddled with administrative liabilities associated with the pre-petition Bonus Plans or Benefits at this time (based upon a "handshake" with Clearlake), when it is unclear whether assumption of such liabilities is appropriate and in the best interests of the Debtors' estates and their unsecured creditors.

26. Approval of the Employee Benefits Motion (with respect to payments under the pre-petition Bonus and Benefits Plans) is not "critical and necessary," "justified under the facts and circumstances" present in these cases, or in the best interests of the Debtors' unsecured creditors. The Debtors have not provided any evidence that the relief sought in the Employee Benefits Motion is necessary at this time, that such relief is in the best interests of the Debtors' estates or that the terms of the pre-petition Bonus Plans meet the standard set forth in the *Global Home Products* test under section 503(c)(3). In addition, to the extent that any of the proposed recipients of payments under the Bonus Plans are "insiders" of the Debtors under section 101(31)

of the Bankruptcy Code, the Debtors have not shown that they have met the strict three prong test set forth under section 503(c)(1) of the Bankruptcy Code. Finally, the Debtors have not explained why it is justified and/or reasonable for the Debtors' employees to receive priority status vastly in excess of the Bankruptcy Code's proscribed limits when the terms that the Debtors have proposed for the Clearlake sale would provide the Debtors' other unsecured creditors with a recovery in the range of 1-3%.

27. In addition to the relief sought in the Employee Benefits Motion, through the KERP Motion, the Debtors seek this Court's approval to implement a post-petition "key employee retention plan," pursuant to which the Debtors propose to pay an aggregate of $475,000 to eligible participants, including $167,000 to employees of two (2) foreign subsidiaries that are not Debtors in these cases. Although the Debtors allege in the KERP Motion that the individuals that would receive payments under the proposed plan are not "insiders," the Debtors did not provide a list or schedule of the individuals set to receive the payments or the amounts any such individuals would receive.

28. As noted above with respect to the Employee Benefits Motion, approval of the KERP Motion at this time is completely improper and unjustified. Moreover, because the Debtors have not provided any detail with respect to who would receive payments under the proposed plan and/or the amounts they would receive, this Court and parties in interest cannot ascertain whether in fact any recipients of payments under the proposed plan are, in fact, "insiders" within the meaning of the Bankruptcy Code. The Debtors have not provided any evidence that the test set forth in *Global Home Products* or the requirements set forth in section 503(c)(1) of the Bankruptcy Code have been satisfied here. The Debtors have also not shown why saddling the Debtors' estate with the significant administrative liabilities associated with the

proposed “key employee retention plan” is warranted at this time when it remains unknown how the sale process will play out and the terms of the proposed sale include a distribution of 1-3% to the Debtors’ unsecured creditors.

CONCLUSION

29. The relief requested by the Debtors in the Employee Retention Motions is premature, unnecessary and not justified under the circumstances. As a consequence, the Employee Retention Motions should not be approved.

WHEREFORE, the Convertible Committee respectfully requests that the Court (i) deny the Employee Retention Motions, and (ii) grant such other and further relief as may be just and proper.

Dated: January 2, 2013
Wilmington, Delaware

ANDREWS KURTH LLP

By: /s/ Paul N. Silverstein
Paul N. Silverstein (*pro hac vice* pending)
Jonathan I. Levine (*pro hac vice* pending)
Jeremy B. Reckmeyer (*pro hac vice* pending)
450 Lexington Avenue
New York, New York 10017
Telephone Number: (212) 850-2800
Facsimile Number: (212) 850-2929

Counsel to the Ad Hoc
Committee of Convertible Noteholders