

Stephen E. Hessler, P.C.  
Marc Kieselstein, P.C.  
Cristine Pirro Schwarzman  
**KIRKLAND & ELLIS LLP**  
**KIRKLAND & ELLIS INTERNATIONAL LLP**  
601 Lexington Avenue  
New York, New York 10022  
Telephone: (212) 446-4800  
Facsimile: (212) 446-4900

James H.M. Sprayregen, P.C.  
Ross M. Kwasteniet, P.C. (admitted *pro hac vice*)  
Brad Weiland (admitted *pro hac vice*)  
John R. Luze (admitted *pro hac vice*)  
**KIRKLAND & ELLIS LLP**  
**KIRKLAND & ELLIS INTERNATIONAL LLP**  
300 North LaSalle Street  
Chicago, Illinois 60654  
Telephone: (312) 862-2000  
Facsimile: (312) 862-2200

*Counsel to the Debtors and Debtors in Possession*

**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

In re:

WINDSTREAM HOLDINGS, INC., *et al.*,<sup>1</sup>

Debtors.

)  
) Chapter 11  
)  
) Case No. 19-22312 (RDD)  
)  
) (Jointly Administered)  
)

**DEBTORS' REPLY IN SUPPORT OF DEBTORS'  
MOTION FOR ENTRY OF AN ORDER APPROVING THE DEBTORS' KEY  
EMPLOYEE INCENTIVE PROGRAM AND DEBTORS' MOTION FOR ENTRY OF AN  
ORDER APPROVING THE DEBTORS' KEY EMPLOYEE RETENTION PROGRAM**

The above-captioned debtors and debtors in possession (collectively, the "Debtors") file this reply to the objection of the United States Trustee (the "U.S. Trustee")<sup>2</sup> and in further support of the Debtors' motions to approve a key employee incentive plan for insider employees [Docket

<sup>1</sup> The last four digits of Debtor Windstream Holdings, Inc.'s tax identification number are 7717. Due to the large number of Debtors in these chapter 11 cases, for which joint administration has been granted, a complete list of the debtor entities and the last four digits of their federal tax identification numbers is not provided herein. A complete list of such information may be obtained on the website of the Debtors' proposed claims and noticing agent at <http://www.kccllc.net/windstream>. The location of the Debtors' service address for purposes of these chapter 11 cases is: 4001 North Rodney Parham Road, Little Rock, Arkansas 72212.

<sup>2</sup> See *Objection of the United States Trustee to Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan* [Docket No. 475] and *Objection of the United States Trustee to Motion for Entry of an Order Approving the Debtors' Key Employee Retention Plan* [Docket No. 474].



No. 405] and a key employee retention plan for non-insider employees [Docket No. 404].<sup>3</sup> The Debtors respectfully state the following in support of this reply.

### **Introduction**

1. The KEIP and KERP are critical to the ongoing success of the Debtors' business and, by extension, a successful and value-maximizing outcome to these chapter 11 cases.

2. The KEIP has one overriding purpose: to drive the business and financial performance that will maximize the near- and long-term value of the Debtors' businesses for the benefit of all stakeholders. As described in the KEIP motion and supporting declarations submitted by Drew Smith (Senior Vice President – Financial Planning and Assistant Treasurer)<sup>4</sup> and Zachary Georgeson (Senior Consulting Director of Willis Towers Watson), the KEIP ensures that the Debtors' insider employees, each of whom is instrumental to the Debtors' success, are properly incentivized to drive performance in the Debtors' highly competitive industry and amidst the very challenging circumstances of the Debtors' chapter 11 cases. Recognizing this, *every one* of the Debtors' key economic stakeholders support approval of the KEIP (including certain modifications agreed among the parties and described below).

3. More specifically, before and after filing the KEIP motion, the Debtors engaged their key economic stakeholders regarding the proposed program to explain the program and its rationale, provide diligence, and respond to questions to build consensus. These efforts were successful—all key creditor constituencies support the KEIP with the following two modifications:

- ***First***, the maximum KEIP payments based on the adjusted OIBDAR performance metric (*i.e.*, payments for achieving adjusted OIBDAR of ten

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<sup>3</sup> Capitalized terms used but not defined herein shall have the meanings set forth in the motions, as applicable.

<sup>4</sup> Contemporaneously with the filing of this reply, the Debtors have submitted a supplemental declaration from Mr. Smith to update the record for events since the KEIP and KERP motions were originally filed and respond to certain of the U.S. Trustee's arguments.

percent above target or higher) will be set at 175 percent of the target payment (reduced from 200 percent of the target payment). This represents a cost savings of over \$1.1 million at the maximum performance level.

- *Second*, 50 percent of all payments for each quarterly performance period will be deferred until the earlier of (a) the Debtors' emergence from chapter 11 and (b) March 1, 2020. Since the originally proposed KEIP provided for payments as soon as practicable after each performance period, this modification represents a potentially significant cost deferral.

4. The Debtors' economic stakeholders recognize what the U.S. Trustee's objection ignores—that the KEIP, and the incentivized efforts of the Debtors' five insider employees, are necessary to drive business performance in chapter 11 even at threshold levels and, without the KEIP, the Debtors could risk losing significant value.

5. The U.S. Trustee's objection argues that the KEIP should not be approved because the Debtors have failed to demonstrate that achievement of the performance targets required by the plan is difficult. That argument (supported by no evidence of its own) ignores the uncontroverted evidence in the Smith declarations and Georgeson declaration and is refuted by the fact that the Debtors' creditors—not in the business of giving money away for free—all support the KEIP (including the threshold-level performance metrics and proposed payouts). Indeed, contrary to the U.S. Trustee's assertions, Mr. Smith's declarations make clear that even the threshold performance levels are "stretch" goals, not easy-to-achieve milestones. The KEIP is quite simply *not* a retention plan. In light of that fact, the Debtors respectfully ask the Court to overrule the U.S. Trustee's objection and approve the KEIP.

6. The KERP, in contrast to the KEIP, was designed specifically as a retention plan, albeit for non-insider employees, to address the particular threat of attrition brought on by the Debtors' chapter 11 filing. The Debtors commenced these cases amidst a great deal of uncertainty caused by the adverse decision in the Uniti spin-off litigation—and with barely any time to take steps to ensure retention of key employees. Under these circumstances, and given the highly

competitive nature of the telecommunications industry, the Debtors are concerned about key employees departing—an unfortunately appropriate concern, since the Debtors have in fact lost certain key employees and understand that others have been aggressively pursued by other employers (including certain of the Debtors’ competitors). Accordingly, after the chapter 11 filing, the Debtors worked (with the advice of Willis Towers Watson) to review their existing, ordinary-course compensation and benefits programs (including retention) to try to reduce the risk of losing key employees. Ultimately, the Debtors developed a new \$5 million retention program focused on the Debtors’ bankruptcy cases to mitigate that risk by strategically granting special retention awards to certain employees.

7. Since filing the KERP motion, the Debtors’ insider management team and human resources personnel have worked to determine an appropriate allocation of some (but not all) of the \$5 million set aside to provide for potential KERP payments. In determining the KERP participants, consistent with what was described in the KERP motion, the Debtors considered whether the employees are (a) a high retention risk and/or essential to ongoing operations, (b) key sales personnel, and (c) employees with a heavier workload due to the chapter 11 cases. The Debtors have provided the current list of proposed KERP participants to the U.S. Trustee. The Debtors were careful to allocate potential KERP payments judiciously. None of the payments will go to any of the Debtors’ five insider employees.

8. The U.S. Trustee’s objection makes three arguments in opposition to the KERP:

- Without identifying the KERP participants, the KERP motion is too vague and effectively asks for authority for the Debtors to pay “whomever they want, whenever they want.”

*Not so.* Even before determining the current proposed list of KERP participants, the Debtors had established parameters for potential participants, potential payment ranges, and the timing of potential payments, all as set forth in the KERP motion.

- Employees with titles including “vice president,” “senior,” or “executive” are insiders that cannot participate in the KERP.

*Not so.* The Debtors’ only insider employees are the five participating in the KEIP. No KERP participants—regardless of title—are officers appointed by the Debtors’ Board of Directors or have any overall corporate policy or decision-making authority that would rise to the level of “control” under the Bankruptcy Code, and section 503(c)(1) does not apply.

- The Debtors have not established that the KERP is justified by the facts and circumstances of these cases.

*Not so.* As noted above, the Debtors’ expedited chapter 11 filing and the surrounding circumstances created a substantial threat of employee attrition that has already led to multiple key employee departures. Without the KERP, the Debtors expect to lose other key employees. To prevent that (and the attendant disruption and loss of value), the KERP should be approved.

9. The KERP is justified in this situation and supported by the Debtors’ sound business judgment. And parties with billions of dollars at stake in these cases have come to the same reasoned conclusion in supporting the KERP. The \$5 million cost of the KERP will create and preserve much greater value. For all of these reasons, the U.S. Trustee’s objection should be overruled, and the KERP approved.

### **Reply**

#### **I. The KEIP Reflects a Sound Exercise of the Debtors’ Business Judgment and Complies with the Requirements of the Bankruptcy Code.**

10. The KEIP is the product of a measured, deliberative, and independent process driven by the Debtors, overseen by the Compensation Committee, and developed in consultation with market guidance from Willis Towers Watson and the Debtors’ restructuring professionals. The result of this process is a plan that will drive performance at a level where all parties will benefit if performance levels are achieved. The realistic yet rigorous performance metrics will require substantial outperformance from all KEIP participants that will set the Debtors on a path

to stability and growth. Without the KEIP, the Debtors' senior management would be undercompensated and under-incentivized at a critical juncture in the Debtors' business lifecycle.

11. Moreover, the cost of the KEIP is reasonable. The KEIP will cost a total of approximately \$5 million at threshold payout levels and approximately \$18.9 million at maximum payout levels (as revised)—in each case assuming performance levels are actually achieved. As described in the Georgeson declaration, the KEIP's proposed award opportunities if performance targets are met is equal to the award opportunities available under the Debtors' prepetition incentive program. As set forth in the Georgeson declaration, the KEIP participants' base compensation plus target payouts will result in total direct compensation one percent above the 25th percentile of market. No party has challenged the Debtors' urgent need to incentivize operational performance or the fact that financial incentives are an appropriate means to achieve this goal, and, in fact, all economic stakeholders support the KEIP.

12. In response to concerns raised by parties in interest, the Debtors have provided additional information and are prepared to present evidence at the hearing on the motions. Especially in light of the Debtors' modifications to the KEIP and as discussed herein, the Debtors believe they have addressed all reasonable concerns and have otherwise carried their evidentiary burden.

13. The U.S. Trustee argues in its objection that the threshold levels needed to pay bonuses under the KEIP are not difficult targets. This is contrary to the uncontroverted evidentiary record. As described in the Smith declarations, achieving the KEIP performance targets in the Debtors' highly competitive industry requires significant "stretch" by the KEIP participants, and KEIP participants will not be eligible to obtain any award simply as a result of "showing up." Cf. *In re Hawker Beechcraft*, 479 B.R. 308, 315 (Bankr. S.D.N.Y. 2007) (denying KEIP approval

where lower threshold was attainable so long as debtor did not encounter “any ‘whoopsies’”). Rather, the Debtors and, in particular, the insider management team must drive successful performance for even a minimum award to be earned.

14. The U.S. Trustee further argues that the KEIP is (a) primarily for retentive purposes and (b) does not satisfy the requirements of the Bankruptcy Code applicable to retention payments. As set forth in detail in the Georgeson and Smith declarations, the KEIP is not a retention program because it requires substantial outperformance by the KEIP participants. *See In re Residential Capital, Inc.*, 478 B.R. 154, 171 (Bankr. S.D.N.Y. 2012) (“When a plan is designed to motivate employees to achieve specified performance goals, it is primarily incentivizing, and thus not subject to section 503(c)(1).”); *In re Mesa Air Group*, No. 10-10018, at \*4 (Bankr. S.D.N.Y. Sept 24, 2010) (finding that an incentive bonus program was not a retention program because it was designed to “motivate the employees to achieve performance goals.”). Since the KEIP is an incentive-based compensation program, not a retention program, section 503(c)(1) of the Bankruptcy Code does not apply. *See In re Hawker Beechcraft, Inc.*, 479 B.R. at 313. In determining whether an employee bonus plan is incentivizing, courts consider whether the plan is “designed to motivate insiders to rise to a challenge or merely report to work.” *Id.* The focus remains on whether the plan is, on the whole, incentivizing in nature by demanding a “stretch” or a “reach” before an award opportunity is achieved. *In re Dana Corp.*, 358 B.R. 567, 581 (Bankr. S.D.N.Y. 2006). As discussed above and in the Smith declaration, the KEIP is appropriately incentivizing.

15. The U.S. Trustee also mischaracterizes the KEIP’s performance goals and incentive structure. The U.S. Trustee argues that the threshold performance levels are too low because they are below prior years’ performance and below the target levels of the Debtors’ 2019 financial

projections. The KEIP sets a baseline expectation of performance in a landscape where OIBDAR and other metrics have been declining since 2017. Certain performance metrics are lower year over year compared to 2018 in order to take into account a trend of declining performance in prior years. For example, 2018 adjusted OIBDAR declined 5.0% year over year compared to 2017, and enterprise contribution margin declined 5.7% year over year. The threshold and target metrics, though, are “stretch” goals for reasons including the following:

- **Adjusted OIBDAR** depends on the Debtors’ achieving success across a number of important business drivers, including sales, customer additions (and minimizing customer losses), and minimizing costs. The KEIP sets a baseline expectation of performance in a landscape where OIBDAR (and other metrics) have been declining since 2017. (As noted above, the Debtors’ 2018 OIBDAR declined 5.0% year over year compared to 2017.) The Debtors’ OIBDAR is projected to improve from historical trends but remains at risk, especially in light of the uncertainty the Debtors face in chapter 11.
- **Enterprise strategic revenue** (related to enterprise products including SD-WAN and “unified communications as a service”) is a key strategic metric for the Debtors’ businesses because it drives overall performance trends and long-term value. Strategic revenue represents higher-margin products for the Debtors and a better and more reliable experience for their customers. Even threshold KEIP performance metrics require improvement from 2018 (on both a full-year and annualized-fourth-quarter basis).
- **Net broadband adds** represents another important metric to drive overall performance by expanding the Debtors’ customer base and building market share. Even threshold performance (20,000 net additions) represents an improvement from 2018 performance (approximately 14,000 net additions) and 2017 (a net loss of approximately 44,000).
- **Enterprise and wholesale contribution margin** (i.e., the enterprise and wholesale segment’s revenue less costs) represents (and requires the segment President to drive) overall performance of the Debtors’ enterprise and wholesale business. This performance metric declined in 2018, and, for the Debtors to change that trend, will require significant efforts to add new customers, maintain existing customers, and manage operational costs.
- Similarly, **enterprise and wholesale service revenue** represents a primary driver of the Debtors’ enterprise and wholesale business. To successfully achieve threshold or target performance, the Debtors must maintain customer churn levels and add new customers—both challenging, especially in the enterprise and wholesale sector which is characterized by aggressive competition.
- The **Kinetic contribution margin** (i.e., the Kinetic consumer segment’s revenue less costs) is an important metric because it represents overall performance of the Debtors’ Kinetic business (which the Kinetic segment President can drive). While the KEIP threshold and



target performance levels reflect declines from 2018, they require improvements within Consumer Revenues of more than 2% year over year, which is the primary driver to Kinetic contribution margin performance.

- **SMB revenue** (*i.e.*, revenue from small- medium-business customers) is an important gauge of the Debtors' performance in an extremely competitive business. (The Debtors face typically higher competition for business customers given that, for example, businesses are more often located in city and town centers where they have access to more telecommunications providers than rurally located customers.) Even at the threshold performance level (reflecting about the same decline faced in 2018), SMB revenue will require significant efforts to achieve.

16. While 2018 showed improvement and demonstrated progress toward strategic goals, it was a reversal of recent trends that the Debtors cannot be certain will continue, especially in light of the Debtors' unexpected chapter 11 filings and resulting publicity. The KEIP performance targets are intended to be challenging but realistic estimates taking into account historic performance and all available factors, not just 2018 performance. The Debtors are optimistic that short term positive results will become a trend—but the KEIP participants will need to work to improve performance and need a realistic goal to strive toward during these chapter 11 cases. The proposed KEIP provides such a goal.

17. Even the threshold performance levels are “stretch” goals, not easy-to-achieve or guaranteed milestones. While threshold performance metrics are easier to achieve than the target and maximum performance metrics, the relative difficulty is reflected in the sliding scale award levels, and threshold performance only generates 50% of the target award. If the threshold performance level is too high, senior management will have no realistic chance to receive a KEIP award and so will be demotivated.

## **II. The KERP Reflects a Sound Exercise of the Debtors' Business Judgment and Complies with the Requirements of the Bankruptcy Code.**

18. The KERP is a sound exercise of the Debtors' business judgment and complies with the requirements of the Bankruptcy Code. The U.S. Trustee argues primarily that the Debtors have

not provided sufficient information regarding and evidence in support of the KERP and that “the officers participating in the KERP are presumed to be insiders.” *See* U.S. Trustee objection ¶ B. The Debtors respectfully submit that the U.S. Trustee is wrong for the following reasons.

19. ***First***, the Debtors provided all available information at the time the KERP motion was filed and have provided additional information since the filing. The KERP motion includes the average minimum, mid-range, and maximum KERP awards available at each seniority level and specifies that no KERP bonus will exceed \$250,000. As described in the KERP motion and accompanying declarations, the KERP participants are not insiders as they have no control of the Debtors and are not tasked with management decisions. The Debtors provided the U.S. Trustee with a list of the KERP participants and certain related information as further evidence that these employees are not insiders. The Debtors also provided extensive KERP diligence to their key creditor constituents—all of whom concluded they had sufficient information to support the KERP.

20. ***Second***, as described in the Smith declarations and in the KERP motion, the KERP participants are not insiders. *See In re Glob. Aviation Holdings Inc.*, 478 B.R. 142, 148 (Bankr. E.D.N.Y. 2012) (“The fact that some of the KERP Employees have the word ‘director’ in their titles does not make them insiders. The label an employer chooses to attach to a position is not dispositive for purposes of insider analysis because ‘[c]ompanies often give employees the title “director” or “director-level” but do not give them decision-making authority akin to an executive.’” (quoting *In re Borders Grp., Inc.*, 453 B.R. 459, 469 (Bankr. S.D.N.Y. 2011)); *In re Kunz*, 489 F.3d 1072, 1078 (10th Cir. 2007) (it is not simply the title “director” or “officer” that renders an individual an insider; rather it is the set of legal rights that a typical corporate officer or director holds)).

21. The Debtors have only five insiders—the KEIP participants—and only these five insiders are responsible for corporate decision-making as directed by the Board of Directors. No other employees, even those with the title “vice president,” “senior,” or “executive” has “decision-making authority akin to an executive.” *See In re Borders*, 453 B.R. at 469. Similar to the employees in *In re Global Aviation*, none of the KERP participants makes governance decisions for the company. 478 B.R. at 148. And similar to the employees in *In re Borders*, the KERP participants “are responsible for running the Debtors’ day-to-day operations” and do not have “the authority to implement company policies.” 453 B.R. at 469. As was found by the courts in *In re Global Aviation* and *In re Borders*, the KERP participants are not insiders here. None of the KEIP participants are eligible to participate in the KERP. As set forth in Mr. Smith’s declarations and as the Debtors are prepared to demonstrate at the hearing, the five KEIP participants are the only officers who constitute insiders as defined in the Bankruptcy Code.

22. **Third**, the KERP is justified by the facts and circumstances of these chapter 11 cases. The KERP participants are critical to the Debtors’ businesses, and, absent the opportunity for retention payments, many of these critical employees would inevitably depart—hence, the Debtors’ understandable, reasoned judgment that steps should be taken to retain them. *See In re Velo Holdings Inc.*, 472 B.R. 209, 212 (Bankr. S.D.N.Y. 2012) (noting that “the ‘facts and circumstances’ language of section 503(c)(3) creates a standard no different than the business judgment standard under section 363(b)”); *In re Borders*, 453 B.R. at 473–74 (evaluating debtors’ KERP under business judgment rule); *In re Dana Corp.*, 358 B.R. at 576–77 (describing six factors that courts may consider when determining whether the structure of a compensation proposal meets the “sound business judgment” test in accordance with section 503(c)(3) of the Bankruptcy Code).

23. As set forth in the declarations and in the KERP motion, the aggregate approximate cost of \$5 million is reasonable when compared to the size of the Debtors' businesses and the relief granted by other courts in this district. *See, e.g., In re Westinghouse Electric Co. LLC*, No. 17-10751 (Bankr. S.D.N.Y. Sept. 12, 2017) (approving a KERP for 210 of the debtors' non-insider employees with total cost of \$13.8 million); *In re Aéropostale, Inc.*, No. 16-11275 (Bankr. S.D.N.Y. July 1, 2016) (approving a KERP for 38 employees with approximate payout of \$1.4 million); *In re SunEdison Inc.*, No. 16-10992 (Bankr. S.D.N.Y. July 29, 2016) (approving a KERP for 126 employees with an estimated payout of \$7.0 million); *In re NII Holdings, Inc.*, No. 14-12611 (Bankr. S.D.N.Y. December 10, 2014) (approving a KERP for twelve employees with an approximate total cost of \$1.24 million). Moreover, as described in detail in the KERP motion and the declarations submitted in support, the relief requested in the KERP motion is critical to retain key employees, certain of whom have already received, or may in the future receive, offers of alternative employment. Accordingly, given the reasonable business justifications for the KERP set forth herein, in the KERP motion, and in the supporting declarations, the KERP should be approved.

### **Conclusion**

24. The Debtors have crafted appropriate incentive and retention programs that address their business needs. All parties will benefit if business leaders are reasonably incentivized and key employees are retained at this critical point in the restructuring process, and the KEIP and KERP achieve this goal at a reasonable cost. The Debtors respectfully submit that the objections of the U.S. Trustee should be overruled and that the KEIP and KERP be approved.

WHEREFORE for the foregoing reasons and upon the motions, the declarations filed in support therewith, the Debtors respectfully request that the Court overrule the objections and approve the motions.

Dated: May 13, 2019  
White Plains, New York

/s/ Stephen E. Hessler

Stephen E. Hessler, P.C.

Marc Kieselstein, P.C.

Cristine Pirro Schwarzman

**KIRKLAND & ELLIS LLP**

**KIRKLAND & ELLIS INTERNATIONAL LLP**

601 Lexington Avenue

New York, New York 10022

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- and -

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