IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

In re INTELSAT S.A., *et al.*, Debtors.	Case No. 20-32299-KLP Chapter 11 (Jointly Administered)

OBJECTION OF THE UNITED STATES TRUSTEE TO DEBTORS' MOTION FOR ENTRY OF AN ORDER (A) APPROVING THE DEBTORS' KEY EMPLOYEE INCENTIVE PLAN AND (B) GRANTING RELATED RELIEF

John P. Fitzgerald, III, Acting United States Trustee for Region Four, which includes the Eastern District of Virginia, Richmond Division, by and through undersigned counsel, in furtherance of the duties and responsibilities set forth in 28 U.S.C. § 586(a)(3) and (5) and pursuant to 11 U.S.C. §§ 307 and 503, the Federal Rules of Bankruptcy Procedure, and the Local Bankruptcy Rules for this District, hereby files his objection to the Debtors' Motion for Entry of an Order Approving the Debtors' Key Employee Incentive Plan (the "KEIP") and (B) Granting Related Relief (the "KEIP Motion"). *See* ECF Doc. 307. In support of his objection, the United States Trustee represents and alleges as follows:

I. PRELIMINARY STATEMENT

Intelsat S.A. and certain of its affiliates (collectively, the "Debtors") filed for bankruptcy protection on May 13, 2020. The KEIP Motion seeks, *inter alia*, authority to pay up to $17

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million in bonuses to 6 of its most highly compensated executives. This is in addition to the approximately $7 million in retention bonuses that the same executives received shortly before the bankruptcy filing.

Pursuant to Section 503(c)(1) of the Bankruptcy Code, insiders cannot be paid retention bonuses absent proof that:

(1) the insider has a "bona fide job offer from another business at the same or greater rate of compensation;"
(2) the services provided by the insider are essential to the survival of the business; and
(3) the bonus cannot be more than ten times the mean retention bonus paid to non-management employees in the same calendar year.

See 11 U.S.C. § 503(c)(1). Because this exacting standard for retention bonuses is difficult to satisfy, most debtors, including the Debtors here, instead seek authority to pay bonuses to insiders under Section 503(c)(3).

To avoid eviscerating the rigorous restrictions on retention bonuses imposed by Section 503(c)(1), bonus payments to insiders of the type sought in the KEIP Motion are subject to strict standards before the Court can approve them under Section 503(c)(3). Among the hurdles that must be met to pass muster under Section 503(c)(3) are that the bonuses must be justified by the facts and circumstances of the case and the thresholds must be genuinely incentivizing and not solely for the purpose of inducing those insiders to remain with the Debtors' business.

As discussed more fully below, the Debtors have failed to meet their burden under Section 503(c)(3) for many reasons:

- Two out of the three performance metrics for the KEIP, Adjusted EBITDA and Total Network Availability, are not defined.

- While insiders' recoveries under the KEIP are tied in part to target thresholds for Adjusted EBITDA and Total Network Availability, the KEIP Motion and the Declaration that accompanies it are devoid of any information regarding the historical, present, and projected Adjusted EBIDTA and Total Network Availability figures necessary to draw comparisons to determine whether the KEIP is not simply a KERP wearing KEIP clothing.

- The Debtors have not established that the C-Band Clearing Targets are incentivizing. Since clearing the C-Band is unprecedented, it is unclear how the Debtors can establish that the C-Band Clearing Targets are actually difficult to reach. In any event, the KEIP Motion and the Declaration that accompanies it are silent on that issue.

- The bonuses proposed under the KEIP are not tied to cash flow so that they will be paid even if the Debtors sustain losses.

- The KEIP Motion fails to state what extra services the executives would perform beyond their ordinary job duties if they were not additionally incentivized.

If the KEIP establishes thresholds that are too easy to satisfy, it is simply retentive and must be evaluated under Section 503(c)(1). Even if the Court determines that the KEIP is not primarily retentive, however, approval of the KEIP Motion should still be denied. Congress's intention in promulgating Section 503(c) was to curtail payments to insiders. Even under the less exacting standards of Section 503(c)(3), the KEIP: (1) fails to establish a reasonable relationship between bonuses and the goals to be achieved, and; (2) is not fair and reasonable. As outlined below, the Debtors have not met their burden with regard to the KEIP, and the KEIP Motion should be denied.

II. FACTUAL BANKGROUND

A. General

1. On May 13, 2020 (the "Petition Date"), Intelsat, S.A. and 34 of its affiliated companies commenced voluntary cases under Chapter 11 of the Bankruptcy Code. ECF Doc. No. 1. By Order entered on May 15, 2020, the Court authorized joint administration of the cases for procedural purposes. ECF Doc. No. 89. Since the orders for relief under chapter 11 were entered, the Debtors have operated as debtors-in-possession under Sections 1107(a) and 1108 of the Bankruptcy Code. To date, no trustee or examiner has been appointed in these chapter 11 cases.

3. On May 27, 2020, pursuant to Section 1102(a)(1) of the Bankruptcy Code, the United States Trustee appointed the Official Committee of Unsecured Creditors ("Committee"). ECF. Doc No. 193.

The KEIP Motion

4. On June 9, 2020, the Debtors filed the KEIP Motion. ECF Doc. No. 307. The KEIP Motion is supported by the Declaration of Zachary P. Georgeson, a Senior Consulting Director at Willis Towers Watson, U.S., LLC (the "Georgeson Declaration").

5. The KEIP Motion seeks authority to implement a bonus plan, which the Debtors describe as an incentive plan, for six key members of the Debtors' management team, including the following: (a) the Chief Executive Office ("CEO"), (b) the Chief Financial Officer ("CFO"), (c) the General Counsel, (d) the Chief Commercial Officer, (e) the Chief Services Officer, and (f) the Senior Vice President, Strategy and Planning. *See* KEIP Motion at ¶ 17.

6. Under the KEIP, the participants can earn quarterly cash incentive payments, but only if the Debtors achieve certain performance targets, called "Performance Metrics." *See id.* at ¶ 16.

7. More specifically, the KEIP payments for each quarter are dived among "threshold," "target," and "stretch" goals – *i.e.* "Threshold Award Opportunity," "Target Award Opportunity," and "Maximum Award Opportunity." *See id.* at ¶ 17.

8. These "opportunities" are based on a blend of three Performance Metrics: A) Adjusted EBITDA; 2) Total Network Availability, and; 3) C-Band Clearing Targets. *See id.* at ¶ 16. Further details of the Performance Metrics are set out on Exhibit C to the KEIP Motion.

9. The KEIP participants receive no payment under the KEIP if the Debtors' do not meet the threshold targets. *See* Georgeson Declaration at ¶ 12. The KEIP provides a threshold award opportunity of approximately 5.7 million dollars in the aggregate. *See* KEIP Motion at ¶

17. At most, the KEIP provides for total payments of just over 17 million dollars if the maximum awards are achieved. *Id.*

10. The amounts available to each of the insiders eligible for payments under the KEIP are detailed in ¶ 12 of the Georgeson Declaration. It is unclear how those amounts were determined. They do not appear to bear any relationship to the insider's pre-petition salary.

Bonuses Received Immediately Prior to the Petition

11. As the Debtors admit, some of the KEIP participants received retention payments immediately prior to the Petition Date. *See* Georgeson Declaration at ¶ 10. The only information disclosed regarding this in the KEIP Motion is "that certain retention-based payments were pre-paid to KEIP participant in May 2020 subject to various recapture milestones in 2020 and 2021." *See id.*

12. The 8-K filed on April 30, 2020 disclosed that the Board of Directors approved retention bonuses for all of the six insiders at issue in the KEIP Motion on the eve of bankruptcy. These bonuses totaled $6,946,000. These retention bonuses were paid on May 6, 2020, one week before the bankruptcy filings.

<u>ARGUMENT</u>

I. Applicable Legal Standard

The Debtors seek approval of the KEIP under Section 503 of the Bankruptcy Code. That Section governs the allowance of administrative expenses "for actual, necessary costs and expenses of preserving a debtor's bankruptcy estate." 11 U.S.C. § 503(b)(1)(A). The two general overriding policies of Section 503 are: (i) to preserve the value of the estate for the benefit of its creditors and (ii) to prevent the unjust enrichment of insiders of the estate at the expense of its creditors. *See In re AMR Corp.*, 490 B.R. 158, 164-65 (Bankr. S.D.N.Y. 2013).

Section 503(c) was added to the Bankruptcy Code in 2005 to respond to "glaring abuses of the bankruptcy system by the executives of giant companies like Enron Corp. and WorldCom Inc. and Polaroid Corporation, who lined their own pockets but left thousands of employees and retirees out in the cold." (Floor Statement, quoted in *In re Dana Corp*., 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006) ("*Dana II*"). *See also In re Hawker Beechcraft, Inc*., 479 B.R. 308, 312-13 (Bankr. S.D.N.Y. 2012) (quotations omitted) ("Congress enacted § 503(c) as part of the 2005 BAPCPA amendments of the Bankruptcy Code to 'eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process'"). The abuses at which the provision is aimed regularly manifest themselves in the guise of retention plans. *See* 3 Collier on Bankruptcy ¶ 503.17[1] at 503-105 (16th ed. 2013) (Section 503(c)'s "purpose was to limit the scope of . . . programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor").

As this Court previously explained:

> All too often [insider retention plans] have been used to lavishly reward – at the expense of the creditor body – the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight. But even where external circumstances rather than the executives are to blame, there is something inherently unseemly in the effort to insulate executives from the financial risks all other stakeholders face in the bankruptcy process.

In re U.S. Airways, Inc., 329 B.R. 793, 797 (Bankr. E.D. Va. 2005). Congress therefore determined that Section 503(c) was necessary "to limit a debtor's ability to favor powerful insiders economically and at estate expense during a chapter 11 case." *In re Pilgrim's Pride Corp*., 401 B.R. 229, 234 (Bankr. N.D. Tex. 2009).

Through Section 503(c), Congress prohibits debtors from paying bonuses to executives and insiders "simply for staying with the Company through the bankruptcy process." *In re Global Home Prods., LLC.*, 369 B.R. 778, 783-84 (Bankr. D. Del. 2007). Rather, under Section 503(c)(1), a Debtor may only provide a bonus designed to cause an insider to remain in the

Debtor's employ if:

(1) the bonus payment is essential to the retention of the employee because the employee has a "bona fide job offer from another business at the same or greater rate of compensation;"
(2) the services provided by the employee are essential to the survival of the business; and
(3) the amount of the payment is within the parameters set by the statute.

See 11 U.S.C. § 503(c)(1). After the passage of Section 503(c), a retention plan payable to insiders can no longer be "justified solely on the debtor's business judgment." *In re Velo Holdings, Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012); *In re Borders Grp. Inc.*, 453 B.R. 459, 470-471 (Bankr. S.D.N.Y. 2011). If a proposed transfer falls within Section 503(c)(1), then the business judgment rule does not apply, irrespective of whether a sound business purpose may actually exist. *See In re Dana Corp*., 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) ("*Dana I*"). Rather, a transfer to an insider to induce the insider to remain with the debtor's business must satisfy the requirements under subdivisions (A), (B), and (C) of Section 503(c)(1). *See e.g. In re Residential Capital, LLC*, 478 B.R. at 169 ("[I]f a debtor proposes to (i) make a transfer or incur an obligation; (ii) to or for the benefit of an insider of a debtor; (iii) for the purpose of retaining that insider, it must meet the strict requirements of Section 503(c)(1)."); *Dana II*, 358 B.R. at 575 (summarizing the requirements under Section 503(c)(1) of the Bankruptcy Code).

After the addition of Section 503(c) to the Bankruptcy Code in 2005, debtors began to craft performance-based insider incentive plans with some retentive elements to avoid the stringent requirements imposed by Section 503(c)(1) on insider retention bonuses. In determining whether Section 503(c)(1) applies to such plans, courts have framed the issue as whether the plans are "pay to stay" retention plans or "pay for value" compensation plans offering incentives based on performance. *See Global Home Prods,* 369 B.R. at 783.

The proponent of a purported "incentive" plan bears the burden of proving that the proposed plan is not a pay-to-stay retention plan governed by Section 503(c)(1). *See In re Residential Capital, LLC*, 478 B.R. at 170 (sustaining U.S. Trustee objection to insider bonuses proposed by affiliated debtors). A debtor's label of a plan as incentivizing to avoid the strictures of Section 503(c)(1) must be viewed with skepticism; the circumstances under which the proposal is made and the structure of the compensation package control. *Id.* (*citing In re Velo Holdings, Inc.*, 472 B.R. at 209-210). A plan that does not require additional work or effort beyond that contemplated prepetition is not an incentive plan, but is retentive, and cannot be approved under the more lenient standards for incentive plans. *In re Patriot Coal Corp.*, 492 B.R. 518, 531 (Bankr. E.D. Mo. 2013) (citations omitted).

B. The KEIP Motion Must Be Denied Because the Debtors Have Failed to Meet Their Burden to Prove that the KEIP Meets the Requirements of Section 503(c)(1)

As a threshold matter, the participants are all officers or "officers in control" of the Debtors, and thus qualify as "insiders" within the meaning of 11 U.S.C. § 101(31). The Debtors admit the participants are "insiders." *See* KEIP Motion at ¶ 11. Whether the KEIP is subject to the standards of Section 503(c)(1) or 503(c)(3), therefore, hinges upon whether it is primarily retentive. *See In re Residential Capital*, 478 B.R. at 170 ("In order to show that the more permissive section 503(c)(3) applies, the Debtors must establish by a preponderance of the evidence that the KEIP is primarily incentivizing and not primarily retentive."). Said differently, the Debtors must demonstrate that the KEIP presents challenging standards and significant hurdles that are difficult to achieve. *See In re Hawker Beechcraft*, 479 B.R. at 313.

Here, the Debtors have failed to satisfy their evidentiary burden that this is not simply a KERP with KEIP window dressing. As discussed further below, there is no information provided in the KEIP Motion to support the fact that that KEIP is incentivizing and not primarily retentive in nature. The KEIP should only be approved if the Debtors satisfy the standards of

Section 503(c)(1) – which they have not.

The initial concern in evaluating any proposed "incentive" plan – such as the KEIP proposed in the KEIP Motion – is that it is merely a disguised KERP. *Hawker Beechcraft*, 479 B.R. at 312-13; *Velo Holdings*, 472 B.R. at 209 (reasoning that courts must be wary of attempts to characterize what is essentially an insider retention plan as an "incentive" plan "to bypass the requirements of section 503(c)(1)" and should "consider the circumstances under which particular proposals are made, along with the structure of the compensation packages, when determining whether the compensation programs are subject to section 503(c)(1)"). S*ee also Dana I*, 351 B.R. at 102 n. 3 ("If it walks like a duck (KERP), and quacks like a duck (KERP), it's a duck (KERP)").

The Court must examine any proposed KEIP to determine whether the milestones resulting in payment are "designed to motivate insiders to rise to a challenge or merely report to work." *Hawker Beechcraft*, 479 B.R. at 313. While stating that the purpose of the KEIP is to "incentivize" the participants, the Debtors have not advanced any evidence or information to demonstrate that the retentive effect of the KEIP is not its primary purpose.

First, the performance metrics for the KEIP are not clear. The first performance metric is "Adjusted EBITDA," but the KEIP Motion never explains what "adjustments" are going to be made to EBITDA or who makes those adjustments. Likewise, the KEIP Motion does not explain how Total Network Availability, the second of the three performance metrics, is determined or who makes that determination.

Second, there is nothing in the proposed KEIP that ties the recoveries of the participants to the recoveries of creditors or other stakeholders. Rather, the participants will be paid quarterly bonuses if certain thresholds are met. What is missing from the KEIP Motion, the Georgeson Declaration, or any exhibit filed to date in support of the KEIP Motion, is any information that provides a comparison of historical, present, or projected Adjusted EBIDTA or Total Network Availability.[1] Aside from general statements that the thresholds proposed in the KEIP Motion are challenging to achieve, there has been no information advanced or analysis presented regarding the likelihood that it will be achieved. *See, e.g, In re Hawker Beechcraft, Inc.*, 479 B.R. at 313 (S.D.N.Y. 2012) (court must determine whether proposed targets "are designed to motivate insiders to rise to a challenge or merely report to work").

Third, there is no evidence presented to date that the Performance Metrics are actually incentivizing. According to the KEIP Motion, the KEIP payments are divided between "threshold," "target," and "stretch" goals. *See* KEIP Motion at ¶ 17. The Performance Metrics are detailed on Exhibit C to the KEIP Motion. There is very little information, however, regarding how the target Performance Metrics were determined. One assumes the Adjusted EBITDA and Total Network Availability Performance Metrics are based on the Debtors' historical performance, but there no historical data provided. With regard to the C-Band Clearing Targets performance metric, the KEIP Motion makes clear that the Debtors' efforts to clear the C-Band are essentially unprecedented. The Debtors do not offer any insight as to how they have set the C-Band Clearing Targets. Without any historical information regarding clearing the C-Band, how can one be certain that the targets are actually incentivizing and not just a series of proforma targets?

Fourth, the KEIP faces a different problem in that the bonuses are not tied to cash flow. It is possible that the Debtors will pay the KEIP payments when they are operating at a loss or has negative cash flow. The Debtors should only be permitted to pay incentive bonuses if cash flow warrants it after the payment of all expenses.

[1] The Debtors have provided some historical information to the United States Trustee regarding Adjusted EBITDA and Total Network Availability, but none of it has been put into the public record in the case.

Finally, other than the Chapter 11 case and the C-Band Clearing, the Debtors fail to identify any new duties that each of the participants will undertake. The key insider employees that are part of the KEIP are already under an obligation to work their hardest for the Debtors. They are already paid handsomely for that hard work. In addition to their salaries, the insiders covered by the KEIP received sizable retention bonuses a week before the bankruptcy filing. The KEIP, therefore, is not an incentive for these employees to work harder, it is a carrot to keep these insiders from leaving for greener pastures.

C. Even if the KEIP Were Governed by Section 503(c)(3), it is Still Deficient

If the Court finds that Section 503(c)(1) does not apply, the Court may also consider whether the payments are permissible under Section 503(c)(3). *Dana II,* 358 B.R. at 575. The text of Section 503(c)(3) places a fact-finding duty upon the bankruptcy court to determine whether a payment outside the ordinary course of business was justified.

In adopting Section 503(c), Congress expressly moved away from the general permissive standard of Section 363(b) towards a more specific statutory prohibition of bonus payments absent factual findings of justification by the bankruptcy court. 11 U.S.C. §503(c)(3). *See GT Advanced Techs. Inc. v. Harrington*, No. 15-CV-069-LM, 2015 WL 4459502, at *7 (D.N.H. July 21, 2015) ("§ 503(c)(3) directs courts to give plans such as the KEIP in this case more scrutiny than is required by the § 363(b)(1) business judgment test"); *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236-237 (Bankr. N.D. Tex. 2009) (Section 503(c)(3) sets a higher standard of review and should not be equated to the business judgment rule as applied under Section 363; to do so would render 503(c)(3) redundant).

Thus, it is clear that Section 503(c) 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." *Pilgrims' Pride*, 401 B.R. at

237. To evaluate whether a proposed bonus plan passes muster under Section 503(c)(3), courts generally consider the following factors outlined in *Dana II*:

> 1. Is there a reasonable relationship between the plan proposed and the results to be obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, 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; does it apply to all employees; does it discriminate unfairly?
>
> 4. Is the plan or proposal 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; what is available; what is generally applicable in a particular industry?
>
> 6. Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?
>
> *See Dana II,* 358 B.R. at 576-77.

Here, the Debtors have failed to satisfy several of the factors. First, the KEIP does not establish a relationship between effort and outcome. As stated previously, it is not evident that any of the thresholds are challenging to meet. Even under the less rigorous standards of Sections 503(c)(3) and 363, and the benchmarks for the payments of bonuses must be “difficult targets to reach.” *Dana II*, 358 B.R. at 583. As set forth above, the Debtors have not provided the Court with the facts and analysis necessary to determine whether a reasonable relationship exists between the proposed bonuses and the results to be obtained. The KEIP Motion is devoid of any historical, present, or projected information regarding the Debtors’ Adjusted EBITDA or Total Network Availability and there is no explanation regarding how the C-Bad Clearing Targets were created.

Second, the Debtors have failed to establish that the KEIP is fair and reasonable and does not discriminate against non-insider employees. A week prior to the Petition Date, the same insiders who are now eligible to earn payments under the KEIP were awarded nearly 7 million dollars of retention bonuses. While certain non-insiders are eligible for bonuses of various sorts, the Debtors do not provide a comparison of insider and non-insider programs.

CONCLUSION

The Debtors have failed to show that the KEIP does not contemplate impermissible retention payments to the Debtors' insiders. The Debtors have also failed to show that the KEIP sets sufficiently stringent goals for insiders to meet to obtain the proposed bonuses. The KEIP Motion, therefore, should be denied.[2]

The United States Trustee respectfully requests that the Court sustain the foregoing Objection, deny the KEIP Motion, and grant such other and further relief as the Court may deem just and proper.

Respectfully submitted,

JOHN P. FITZGERALD, III
Acting United States Trustee
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By: /s/ B. Webb King
Trial Attorney

CERTIFICATE OF SERVICE

I hereby certify that, on June 23, 2020, a true copy of the foregoing was delivered via electronic mail pursuant to the Administrative Procedures of the CM/ECF System for the United States Bankruptcy Court for the Eastern District of Virginia to all necessary parties.

/s/ B. Webb King

[2] In the event the Court grants the KEIP Motion, the United States Trustee requests that, for each quarter covered by the KEIP, the Debtors be required to file a statement with the Court setting out whether or not the Performance Metrics were reached, the details regarding same and the amounts paid to each of the insiders.