IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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	:	Chapter 11
In re:	:	
	:	Case No. 16-10527 (MFW)
SPORTS AUTHORITY HOLDINGS, INC., *et al.*,[1]	:	Jointly Administered
	:	
Debtors.	:	Re: Docket No. 2478
	:	
	:	**Hearing Date: August 2, 2016 at 10:30 a.m.**
	:	**Obj. Deadline: July 26, 2016 at 4:00 p.m.**
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OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTORS' MOTION FOR ORDER APPROVING EXECUTIVE INCENTIVE PROGRAM (D.I. 2478)

Andrew R. Vara, the Acting United States Trustee for Region 3 (the "U.S. Trustee"), through his undersigned counsel, hereby objects to the Debtors' Motion for Order Approving Executive Incentive Program (D.I. 2478) (the "Insider Bonus Motion") [2], and in support of his objection respectfully states as follows:

PRELIMINARY STATEMENT

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[1] The Debtors and the last four digits of their respective taxpayer identification numbers are as follows: Sports Authority Holdings, Inc. (9008); Slap Shot Holdings, Corp. (8209); The Sports Authority, Inc. (2802); TSA Stores, Inc. (1120); TSA Gift Card, Inc. (1918); TSA Ponce, Inc. (4817); and TSA Caribe, Inc. (5664). The headquarters for the above-captioned Debtors is located at 1050 West Hampden Avenue, Englewood, Colorado 80110.

[2] Unless otherwise defined herein, capitalized terms shall have the same meaning and context as those capitalized terms included in the referenced or cited document or pleading.

1. The Insider Bonus Motion seeks to pay four insiders up to $2.825 million dollars. These payments come after the sale of substantially all of the Debtors' assets, and when the Debtors are also proposing to pay certain administrative creditors and not others and provide no dividend to unsecured creditors. The payments at issue are retention payments, despite the "metrics" set forth in the Insider Bonus Motion. As such, they are impermissible insider retention bonuses, and the motion should be denied.

STANDING

2. Section 307 of the Bankruptcy Code confers upon the U.S. Trustee the broad right to raise, appear and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307. The U.S. Trustee is not required to demonstrate any pecuniary or other interest. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (Congress was cognizant that the U.S. Trustee would have no pecuniary interest when it enacted Section 307 and conferred standing based upon traditional notions of public interest standing).

BACKGROUND AND FACTS

3. On March 2, 2016, the above-captioned debtors (the "Debtors") filed chapter 11 petitions in this Court. The U.S. Trustee appointed an official committee of unsecured creditors (the "Committee") on March 10, 2016.

4. The Court entered an order approving bid procedures in connection with the sale of substantially all of the Debtors' assets on April 14, 2016. Bids were due with respect to the "main auction" of the Debtors' assets on May 11, 2016, with the hearing to approve the sale of such assets on May 24, 2016. The Debtors did not receive any going concern bids for their assets on an enterprise level, and at the conclusion of the Auctions, the Debtors accepted the bid submitted by a contractual joint venture composed of (i) Gordon Brothers Retail Partners, LLC, (ii) Hilco Merchant Resources, LLC, and (iii) Tiger Capital Group LLC (collectively, the "Agent") for their Retail Inventory. In addition, the Debtors entered into numerous assignment agreements and lease termination agreements disposing of valuable leasehold interests, which generated significant proceeds for the estates.

5. At a hearing on July 15, 2016, the Debtors sought, and were granted, authority to sell their remaining intellectual property, leases for which they received interest, and other miscellaneous assets.

6. Upon information and belief, by July 31, 2016, the Debtors' liquidation will be substantially complete.

7. On July 12, 2016, the Debtors filed the Insider Bonus Motion and a motion to seal certain information contained in the Insider Bonus Motion.[3] *See* Docket No. 2480. The U.S. Trustee is filing a separate objection to the Debtors' sealing request.

8. The Debtors' proposed bonuses are based on three alleged "metrics": "(i) a fixed component dependent upon the Executive Incentive Program Participants remaining employed with the Debtors through certain agreed upon dates; (ii) a variable component dependent upon inventory shrinkage levels (up to the aggregate maximum amount payable to all Executive Incentive Program Participants of $1.5 million); and (iii) a variable component dependent upon controllable wind-down costs (subject to the schedule and percentages set forth in the Executive Incentive Program)." Insider Bonus Motion, ¶13.

9. In total, the Debtors seek authority to pay up to $2.85 million.

OBJECTION

10. Transfers to insiders must be reviewed under 11 U.S.C. §503(c). If a transfer to an insider is for the purpose of inducing the insider to stay with the Debtors, the transfers are allowable only under Section 503(c)(1), even if the transfers are otherwise in the ordinary course of the Debtors' business. *Nellson Nutraceutical*, 369 B.R.787, 800-01 (Bankr. D. Del. 2007) (holding that nothing exists in section 503(c)(1) of the Code that would limit its applicability to transactions or payments made

[3] The seal motion seeks approval to seal the names of the executives receiving the bonuses, the metrics, and the bonus amounts. As a result, this Objection will not refer to that exhibit with any specificity. However, it is important to note that the sealed exhibit is extremely difficult to interpret, in that, for example, it appears to be notated in thousands in some places and other denominations in other places and provides that several terms are "TBD".

outside the ordinary course of business and that the only limitation is that such transfers be "for the benefit of, an insider of the debtor.").

11. Section 503(c) of the Bankruptcy Code provides in pertinent part:

> Notwithstanding subsection (b), there shall neither be allowed, nor paid –
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> (1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtors' business, absent a finding by the court based on evidence in the record that
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> (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
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> (B) the services provided by the person are essential to the survival of the business; and
>
> (C) either –
>
> (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal
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> to 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 is incurred; or
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> (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any
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> similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred.

11 U.S.C. § 503(c).

12. Congress added section 503(c) to the Bankruptcy Code as one of the BAPCPA amendments in 2005, to "eradicate the notion that executives were entitled to bonuses 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). The intent of section 503(c) is to "limit the scope of 'key employee retention

plans' and other programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor." 4 Alan N. Resnick & Henry J. Sommer (eds.), Collier on Bankruptcy ¶ 503.17 (15th ed. rev. 2007); *see also In re Foothills Texas, Inc.,* 408 B.R. 573, 577 (Bankr. D. Del. 2009) (stating that section

13. Section 503(c) restricts debtors from making retention or severance payments to insiders unless its applicable requirements are satisfied. *In re AMR Corp.,* 497 B.R. 690, 696 (Bankr. S.D.N.Y. 2013) (finding that the language of Section 503(c) is prohibitive; if payments to insiders do not comply with the applicable 503(c) provisions, they "shall neither be allowed, nor paid").

14. Section 503(c) establishes specific evidentiary standards that must be met before a bankruptcy court may authorize payments to an insider for the purpose of inducing such person to remain with a debtor's business or payments made on account of severance. *In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) ("*Dana I*"); 11 U.S.C. § 503(c)(1). By enacting the BAPCPA, Congress put into place "a set of challenging standards" and "high hurdles" for debtors to overcome before retention bonuses could be paid. *In re Mesa Air Grp., Inc.*, Case No. 10-10018 (MG), 2010 WL 3810899, *2 (Bankr. S.D.N.Y. Sept. 24, 2010) (citations omitted). The proponent of a bonus plan has the burden of showing that the plan is not a retention plan governed by Section 503(c)(1). *In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 313 (Bankr. S.D.N.Y. 2012).

15. Where section 503(c)(1) applies, the transfer cannot be justified solely on the debtor's business judgment. *See In re Borders Grp., Inc.*, 453 B.R. 459, 470-71 (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. *Id.*; *Dana I*, 351 B.R. at 100; 11 U.S.C. § 503(c)(1).

16. To show that a bonus plan is not governed by section 503(c)(1), the debtors must prove by a preponderance of the evidence that the bonuses are part of a "pay for value" plan that offers incentives based on performance rather than a "pay to stay" plan. *Global Home Prods.*, 369 B.R. at 783; *accord Residential Capital, LLC,* 478 B.R. 170 (Bankr. S.D.N.Y. 2012). If the debtors fail to meet their

burden of proof, then the bonus plan cannot be approved. In addition, although any payment to an employee, including regular wages, has at least a partial purpose of retaining the employee, for bonus plans to fall outside the purview of section 503(c)(1), they must be primarily incentivizing. *In re Nellson Nutraceutical*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (bankruptcy court construed section 503(c)(1) to mean "'a transfer to ... an insider of the debtor for the primary purpose of inducing such person to remain with the debtor's business.'") (citation omitted).

17. Further, 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. *In re Velo Holdings, Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012) ("Attempts to characterize what are essentially prohibited retention programs as incentive programs in order to bypass the requirements of section 503(c)(1) are looked upon with disfavor, as the courts 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).") (internal quotation marks and citations omitted); *see also Residential Capital,* 478 B.R. at 161 (finding that an incentive plan "should incentivize employees for their post-petition efforts, not compensate them for the work they did before the bankruptcy filing."); *Hawker Beechcraft*, 479 B.R. at 313 ("The concern in the type of motion presented ... is that the debtor has dressed up a KERP to look like a KEIP in the hope that it will pass muster under the less demanding 'facts and circumstances' standard in ... § 503(c)(3)."); *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).").

18. In the present case, the Debtors' "incentive" label should be viewed with skepticism. Of the three program pieces, the first piece is clearly retentive, in that it requires only that the program recipient remain until a certain date (which is undisclosed). The other two pieces, while labeled metrics, are either "home runs" or too vague and poorly described to be meaningful, aspirational, targets. The Debtors provide no information regarding how the insiders' services are related to the alleged metrics. These metrics, therefore, do not appear to be true incentives.

19. The first metric piece depends on inventory shrinkage levels. Shrink is a store-level issue, and the majority of the Debtors' inventory has already been liquidated. Therefore, this "metric" appears to be designed to compensate four insiders first, for results over which they have no direct control, and second, that are related to a liquidation that is substantially complete. This metric appears to be anything but aspirational. The second metric piece is related to "controllable" wind down costs. The Insider Bonus Motion is devoid of any explanation of what "controllable" wind-down costs are, or the specific categories of costs to which they relate. It is entirely possible that such costs could be "controlled" by, for example, objecting to and refusing to pay the fees of Committee counsel, or by objecting to or refusing to pay certain categories of claims (e.g., §503(b)(9) claims, WARN Act claims).

20. The retentive nature of the program, coupled with the lack of meaningful metrics, removes the proposal from the "incentive" category, and places it firmly in the "retention" category, thus triggering review pursuant to §503(c)(1). Under §503(c)(1), to obtain approval of its proposed insider bonus program, the Debtors must, "based on evidence in the record," demonstrate all three of its required elements. These include showing a "bona fide job offer from another business at the same or greater rate of compensation" and that the payment does not exceed specified amounts. The Insider Bonus Motion lacks any of this information, and therefore, the Debtors have not and cannot meet §503(c)(1)'s stringent requirements.

21. If a proposed bonus to insiders, like the one in the Insider Bonus Motion, is an incentive plan, rather than a retentive plan, then courts evaluate it under §503(c)(3). That section requires the Debtors to demonstrate that the proposed incentive payments are either in the ordinary course of business, or that they are justified by "the facts and circumstances of the case." 11 U.S.C. § 503(c)(3). The payments here do not appear to be in the ordinary course of business, and the Debtors have not alleged that they are. As a result, the Debtors must demonstrate that such payments are justified by the facts and circumstances of the case. They have not done so. Rather, the Debtors claim that, because the proposed payments are being made by the Term Loan Agent, the Debtors do not need to meet the standards of §503. The Debtors claim that the proposed payments are a pure gift from the Term Loan Agent, and will

not be added to the principal balance of the loan. The payment of the proposed bonuses by the Term Loan Agent raises troubling questions. If the Term Loan Agents, not the Debtors, pay the proposed bonuses, this appears to create a conflict of interest. The executives, who have a fiduciary duty to the estate, are now being compensated by the largest secured creditor, which may create perverse incentives to favor that creditor over others. In fact, this appears to be a problem already, as the Debtors have proposed a settlement with the Term Loan Agent that pays stub rent claims but not claims arising under §503(b)(9), which share the same priority.

22. If, as the U.S. Trustee believes should be the case, the proposed bonus plan is evaluated under the standards of §503(c)(3), the Debtors have not meet their burden, and the payments should not be approved.

23. Transactions outside the ordinary course of business and that relate to incentive-based compensation must be analyzed under the standard set forth in §503(c)(3). In *In re Dana Corp., (Dana II)*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006), Judge Lifland listed several factors that courts consider when determining if the structure of a compensation proposal and the process for its development satisfy §503(c)(3):

- 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?

- Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?

- Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?

- Is the plan or proposal consistent with industry standards?

- 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?

- Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

358 B.R. at 576–77 (emphasis in original). *See Global Home*, 369 B.R. at 786 (evaluating an incentive plan under the business judgment standard of section 363 by applying the factors listed above); *Borders*, 453 B.R. at 474 (same); *but see In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236-37 (Bankr. N.D. Tex. 2009) (standard for approval under section 503(c)(3) is higher than the business judgment test; if payments to employees outside the ordinary course were only subject to the business judgment test, then the language of section 503(c)(3) would ostensibly be rendered meaningless).

24. The Debtors have failed to meet section 503(c)(3)'s standards. Under the standards articulated in *Dana*, the proposed plan does not appear to be either reasonable or fair. The Debtors have put forward no evidence regarding the relationship between the proposed plan and the results they seek. The length, timing, and certain terms of the proposed plan are unclear. Second, in light of the admitted administrative insolvency of these cases (the settlement currently proposed, as noted, pays only some administrative creditors), paying four executives $2.85 million does not appear reasonable, fair, or prudent. Third, only four people are eligible for a vast sum of money, in a case where thousands of employees have lost their jobs and there are potential WARN claims. Fourth, the Debtors provided no information regarding whether industry standards would support the proposed plan. Finally, the proposed metrics are, at best, only tangentially related to circumstances within the proposed recipients' control. If the metrics are not a stretch, but merely just "lay ups" for the executives, the bonuses do not comply with section 503(c)(1) of the Bankruptcy Code and should not be approved.

25. Under the totality of the facts and circumstances presented, the proposed insider bonus plan should be denied. As the court noted in In re *U.S. Airways, Inc.,* 329 B.R. 793, 797 (Bankr. E.D. Va. 2005), management bonus plans "have something of a shady reputation . . . . All too often they 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 the executives from the financial risks all other stakeholders face in the bankruptcy process."

26. Here, the proposed bonuses are exactly that – inherently unseemly. The Debtors fail to explain how providing additional compensation to executives for completing tasks already approved that will result in the loss of hundreds of jobs is fair to all. Moreover, the Debtors fail to explain how the specific metrics will actually preserve or create value of the bankruptcy estate. The proposed bonuses appear to be nothing more than a giveaway to insiders and at best a retention plan which on its face does not meet the requirements of Bankruptcy Code Sections 503(b)(1), 503(c)(1), or 503 (c)(3). Accordingly, the U.S. Trustee respectfully requests that the Court deny the motion.

WHEREFORE, the U.S. Trustee respectfully requests that the Court deny the Insider Bonus Motion and for such other and further relief deemed fair, just and appropriate.

Respectfully submitted,

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ACTING UNITED STATES TRUSTEE

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