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Debtors In Possession

**UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

In re

VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., *et al.*,

Debtors and Debtors In
Possession.

☒ Affects All Debtors

- ☐ Affects Verity Health System of
California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital
Foundation
☐ Affects St. Francis Medical Center of
Lynwood Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center, Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose
Dialysis, LLC

Debtors and Debtors In
Possession.

Lead Case No. 18-20151-ER

Jointly Administered With:

CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20181-ER

Chapter 11 Cases

Hon. Ernest M. Robles

**DEBTORS' NOTICE OF MOTION AND
MOTION FOR ENTRY OF AN ORDER
AMENDING KEY EMPLOYEE INCENTIVE
PLAN; MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT THEREOF;
DECLARATION OF RICHARD G. ADCOCK
FILED CONCURRENTLY HEREWITH**

Hearing:

Date: November 6, 2019
Time: 10:00 a.m.
Location: Courtroom 1568
255 E. Temple St., Los Angeles, CA

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1 **PLEASE TAKE NOTICE** that, at the above referenced date, time and location, Verity
2 Health System of California, Inc., and its affiliated debtors and debtors in possession (collectively,
3 the “Debtors”), will move the Court (the “Motion”) for the entry of an order: (i) amending their
4 key employee incentive plan (the “Amendment” and the “KEIP,” respectively) solely with respect
5 to one provision related to the *date* of the sale of the Debtors’ assets; and (ii) granting related relief.
6 A true and correct copy of the KEIP, redlined with the Amendment, is attached to the accompanying
7 Memorandum of Points and Authorities (the “Memorandum”) as **Exhibit “A.”**

8 **PLEASE TAKE FURTHER NOTICE** that the Motion is based on this Notice, the
9 Motion, the Memorandum, the *Declaration of Richard G. Adcock in Support of Debtors’*
10 *Emergency First-Day Motions* [Docket No. 8], the Declaration of Richard G. Adcock filed
11 concurrently herewith (the “Current Adcock Declaration”), the *Motion for Entry of an Order*
12 *Authorizing and Approving (I) Key Employee Incentive Plan and (II) Key Employee Retention Plan*
13 [Docket No. 631] (the “KEIP/KERP Motion”), the ruling explaining the basis for the granting of
14 the KEIP/KERP Motion [Docket No. 814], the *Order Granting Debtors’ Motion for Entry of an*
15 *Order Authorizing and Approving (I) Key Employee Incentive Plan and (II) Key Employee*
16 *Retention Plan* [Docket No. 893], the entire record of these cases, the statements, arguments and
17 representations of counsel to be made at the hearing on the Motion, if any, and any other evidence
18 properly presented to the Court.

19 **PLEASE TAKE FURTHER NOTICE** that, pursuant to Local Bankruptcy Rule 9013-
20 1(f), any party opposing or responding to the Motion must file a response (a “Response”) with the
21 Bankruptcy Court and serve a copy of it upon the moving party and the United States Trustee not
22 later than 14 days before the date designated for the hearing. A Response must be a complete
23 written statement of all reasons in opposition to the Motion or in support, declarations and copies
24 of all evidence on which the responding party intends to rely, and any responding memorandum of
25 points and authorities.

26 **PLEASE TAKE FURTHER NOTICE** that, pursuant to Local Bankruptcy Rule 9013-
27 1(h), failure to file and serve a timely objection may be deemed by the Court to be consent to the
28 relief requested herein.

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DATED: October 4, 2019

DENTONS US LLP
SAMUEL R. MAIZEL
TANIA M. MOYRON
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By /s/ Tania M. Moyron
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MEMORANDUM OF POINTS AND AUTHORITIES

Verity Health System of California, Inc., a California nonprofit benefit corporation and the Debtor herein (“VHS”), and the above-referenced affiliated debtors, the debtors and debtors in possession (collectively, the “Debtors”) in the above-captioned chapter 11 bankruptcy cases (the “Cases”), hereby move (the “Motion”) the Court, pursuant to §§ 107(b), 363(b), 503(b) and 503(c)¹ and Rules 3002, 3003 and 9018, for the entry of an order: (i) amending the key employee incentive plan [Docket No. 876] (the “KEIP”) approved by the *Order Granting Debtors’ Motion for Entry of an Order Authorizing and Approving (I) Key Employee Incentive Plan and (II) Key Employee Retention Plan* [Docket No. 893] (the “KEIP/KERP Order”), solely with respect to one provision related to the *date* of the sale of the Debtors’ assets, which impacts the bonuses for seven management-level employees (the “Amendment Employees”),² who continue to work diligently at the Debtors’ remaining unsold hospitals/dialysis center (collectively, the “Remaining Hospitals”); and (ii) granting related relief.

I.

INTRODUCTION

The Debtors filed the Cases to conduct “bankruptcy court supervised sale[s] of [their] hospitals and related facilities, and the comprehensive resolution of the Debtors’ financial obligations through a court-approved plan of reorganization.” *Declaration of Richard G. Adcock In Support of Emergency First-Day Motions* [Docket No. 8] (the “First-Day Declaration”) at 25, ¶ 96. The sale process has been occurring in two stages. The first stage occurred relatively quickly and concluded on February 28, 2019, when the Debtors closed the sale of O’Connor Regional

¹ Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all “Rule” references are to the Federal Rules of Bankruptcy Procedure. All references to “LBR” are to the Local Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California.

² The Amendment Employees were all previously disclosed under seal, as authorized by the Court. *See* Docket No. 972; *see also* Docket Nos. 632, 721 and 735. At the time of the filing of this Motion, the Debtors have or will again provide the identities of the Amendment Employees to certain parties who have executed nondisclosure agreements or otherwise have agreed to treat such information as confidential, which include: (i) the Unsecured Creditors Committee, (ii) pre-petition lenders, UMB Bank N.A., as Successor Master Trustee for the Master Indenture Obligations, Wells Fargo Bank National Association as Indentures Trustee for Series 2005 Revenue Bonds, U.S. Bank National Association, as Series 2015 and Series 2017 Note Collateral Agent and Note Trustee, Verity MOB Financing LLC, and Verity MOB Financing II LLC, (iii) McKesson Corporation, and (iv) the United States Trustee.

1 Hospital (“OCH”) and Saint Louise Regional Hospital (“SLRH”) to Santa Clara County. In
2 contrast, the second stage has continued longer than originally envisioned at the outset of these
3 cases. Specifically, on or about May 2, 2019, the Court entered an order authorizing the Debtors
4 to sell their Remaining Hospitals—St. Francis Medical Center, St. Vincent Medical Center, St.
5 Vincent Dialysis Center, Seton Medical Center and Seton Coastsides—to Strategic Global
6 Management, Inc. (“SGM” and the “SGM Sale”). The closing of the SGM Sale, however, has been
7 delayed by the California Attorney General’s review of the SGM Sale (the “AG Review”). This
8 delay, in turn, has prejudiced the Amendment Employees’ recovery under the KEIP in a manner
9 that was not envisioned when the KEIP was approved in the fall of 2018.

10 Specifically, the approved KEIP was structured to incentivize management-level employees
11 of individual hospitals with a bonus that includes a payment up to 15% of a manager’s
12 compensation based upon the timing of closing of a sale. Management who worked at the hospitals
13 sold to Santa Clara County have already received their maximum KEIP bonuses. In contrast, the
14 seven management-level Amendment Employees who have continued to tirelessly work for the
15 Remaining Hospitals throughout the past year, who remain critical to preserving going-concern
16 value of the Debtors, and who had no role in the delay in the sale of their hospital, stand to lose all
17 or a significant portion of the KEIP bonuses tied to sale closing, unless the KEIP is amended. In
18 fact, unless the KEIP is amended, the Amendment Employees will at most receive a sale bonus
19 equal to 3% of their salary if their respective Remaining Hospital(s) are sold before December 31,
20 2019, and \$0 if the sale closes later. Such a result would be inequitable in that it would punish the
21 seven managers who have actually worked longer to provide benefit to creditors of the estate. To
22 address this inequity and to properly incentivize the Amendment Employees to perform through a
23 2019 closing, the Debtors, utilizing their business judgment through a proposed amendment to the
24 KEIP (the “Amendment”) that modifies the “trigger” date for the 15% bonus from March 31, 2019
25 to December 31, 2019 for the Amendment Employees.

26 The requested Amendment comports with law and equity and, is in line with case precedent
27 (see *infra* discussion of the *Lightsquared* bankruptcy where the debtors modified their KEIP due to
28 delayed case milestones caused, in part, by regulatory issues, and not by the key employees). The

Amendment is fair to the Amendment Employees and is in the best interest of the estates as it will facilitate completion of the Debtors' sale to SGM and Cases in an orderly, equitable and beneficial manner. Based upon the foregoing, and for the reasons set forth in greater detail below, the Debtors respectfully request that the Court grant the Motion.

II.

JURISDICTION, VENUE AND BASIS FOR RELIEF

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). The statutory predicates for the relief requested herein are §§ 107(b), 363(b), 503(b), and 503(c).

III.

STATEMENT OF FACTS

A. General Background

1. On August 31, 2018 ("Petition Date"), the Debtors each filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Since the commencement of their Cases, the Debtors have been operating their businesses as debtors in possession pursuant to § 1107 and 1108 of the Bankruptcy Code.

2. Additional background facts on the Debtors, including an overview of the Debtors' business, information on the Debtors' debt structure and information on the events leading up to the chapter 11 cases, are contained in the First-Day Declaration.

B. Facts Relevant to Motion

3. On October 23, 2018, the Debtors filed their *Motion for Entry of Order Authorizing and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan* [Docket No. 631] (the "KEIP/KERP Motion") (which the Debtors incorporate in full herein). In the KEIP/KERP Motion, the Debtors sought the Court's approval of their KEIP and a Key Employee Retention Plan ("KERP"). The KEIP/KERP Motion was unopposed.

4. On November 13, 2018, the Court issued a ruling [Docket No. 814] (the "KEIP/KERP Ruling," attached as **Exhibit "B"**) approving the KEIP and KERP. The Court found

1 that the Debtors had met the “business judgment” standard of § 363(b) and the requirements of
2 § 503(b) for payments to employees outside of the ordinary course of business, as well as the factors
3 articulated in *In re Dana Corp.*, 358 B.R. 567, 576–77 (Bankr. S.D.N.Y. 2006) (the “Dana
4 Factors”). KEIP/KERP Ruling at 4. The KEIP/KERP Ruling was followed by the entry of the
5 KEIP/KERP Order on November 28, 2018.

6 5. Notably, the KEIP/KERP Order authorized the “Entity KEIP” (as defined in the
7 KEIP/KERP Motion) to incentivize individuals responsible for the management of a respective
8 hospital. The Entity KEIP had an original sixteen participants, all of whom were (and, as to the
9 Amendment Employees, still are) employees of the Debtors’ hospital entities (and not of VHS) (the
10 “Entity KEIP Participants”). The Amendment Employees are the seven Entity KEIP Participants
11 that still remain employed by the Debtors.

12 6. The Entity KEIP is tied to two metrics: (1) the Debtors meeting a cash flow target,
13 based on adherence to the DIP budget (“Net Cash Flow Target”) measured through the earlier of
14 (i) the date of termination without cause, (ii) complete repayment of the DIP loan, or (iii) June 30,
15 2019 (“DIP Measure Date”); and (2) the timing of when Debtors close the sale of the employees’
16 respective hospital employer (the “Closing Metric”). The Debtors met the Net Cash Flow Target
17 on the DIP Measure Date, and all Entity KEIP Participants were duly paid the required bonus of
18 15% of their salary. *See* Current Adcock Declaration, ¶ 6.

19 7. As to the Closing Metric, each Amendment Employee’s potential remaining
20 maximum KEIP payment is currently capped at an additional 3% of their respective annual salary,
21 but only payable if the sale of their respective hospital closes by December 31, 2019, with no
22 additional bonus to be paid for any later sale. *See* Current Adcock Declaration, ¶ 7.

23 8. On December 27, 2018, after the culmination of a bankruptcy marketing process that
24 began almost immediately after the Petition Date, the Court entered an order approving the sale of
25 all assets (excluding cash, accounts receivables and causes of action) of OCH and SLRH [Docket
26 No. 1153]. Due to the significant efforts of the Debtors’ key employees, who made themselves
27 available for diligence and transition issues with the buyer and who helped maintain the going-
28

1 concern value of those two hospitals, the SCC Sale closed on February 28, 2019, resulting in \$235
2 million in sales proceeds to the Debtors' estates.

3 9. The Entity KEIP Participants employed by OCH and SLRH thereupon became
4 entitled to (and ultimately received) the maximum bonus tied to the timing of that sale (15% of
5 salary), because the SCC Sale closed before the Closing Metric date of March 31, 2019. *See* Current
6 Adcock Declaration, ¶¶ 8 and 9.

7 10. On April 17, 2019, the Court held a hearing to approve the SGM Sale and the Asset
8 Purchase Agreement between the Debtors and SGM [Docket No. 2305], dated January 8, 2019 (the
9 "APA"), which has a purchase price of \$610 million. On May 2, 2019, the Court entered an order
10 approving the SGM Sale. *See* Docket No. 2306. The APA has an outside date for closing of the
11 SGM sale of December 31, 2019 (the "Closing"). *See* APA at §§ 9.1(e) & (f).³

12 11. The Closing has not yet occurred. The AG took the full time to issue a decision
13 regarding the SGM Sale (September 25, 2019) and in it, has sought to impose several conditions.
14 The Debtors filed an emergency motion on September 30, 2019 challenging the AG's decision
15 [Docket No. 3188], and the Court has set a hearing date on this motion for October 15, 2019 [Docket
16 No. 3193]. As explained, if the Closing occurs before December 31, 2019, the Amendment
17 Employees would only be entitled to receive a remaining bonus of 3% of their salary (as opposed
18 to their OCH and SLRH counterparts who received the full 15% for the closing of the SCC Sale),
19 despite the fact that they have performed longer to preserve the value of the Remaining Hospitals.
20 *See* Current Adcock Declaration, ¶ 10.

21 12. Though the Debtors have and continue to pay all their employees timely and in the
22 ordinary course, including scheduled wage increases and PTO, the Debtors face a material attrition
23 risk and morale concerns with their Amendment Employees. For instance, Seton Medical Center
24 has lost its Chief Financial Officer and Chief Nursing Officer (representing two of its top three
25 executives), both of whom were Entity KEIP Participants. *See* Current Adcock Declaration, ¶ 11.

26 13. The Debtors have determined that the Entity KEIP should be amended for the
27 Amendment Employees, whose efforts and expertise are integral to preserving the Debtors' assets
28

³ The Debtors reserve the right to seek further amendments of the KEIP, including extensions into 2020.

1 and closing the SGM Sale, and who have no culpability for the delay of the sale of their employers.
2 See Current Adcock Declaration, ¶ 14.

3 14. The Debtors seek the Amendment to modify the KEIP, so that, if the SGM Sale
4 occurs before December 31, 2019, the Amendment Employees will receive a bonus of 15% of their
5 salary instead of the current amounts of 3%, with any later Closing resulting in no Closing Metric
6 bonus. Otherwise, the Court-approved KEIP terms will remain in place. See Current Adcock
7 Declaration, ¶¶ 7 and 15. A redline of the KEIP reflecting the Amendment is attached hereto as
8 **Exhibit “A.”**

9 15. Compared to the Current KEIP, the Amendment represents an incremental cost of
10 \$305,204. If the sale had closed by March 31, 2019, the bonuses would have totaled \$462,975,
11 which is comprised of the bonuses that would have been paid to nine Entity KEIP Participants.
12 Thus, the Debtors had already anticipated paying these bonuses and would, in fact, pay less given
13 that there are now seven employees who are Entity KEIP Participants (*i.e.*, the Amendment
14 Employees). Based on the foregoing, coupled with the considerations discussed above, the Debtors,
15 in their business judgment, have determined that the Amendment’s price is worth paying to preserve
16 morale and incentivize the Amendment Employees to facilitate the Closing of the \$610 million
17 SGM Sale. See Current Adcock Declaration, ¶ 16.

18 **IV.**

19 **ARGUMENT**

20 **A. The Amendment Meets the Business Judgment Test**

21 Section 503(c)(3) requires that payments to a debtor’s employees outside of the ordinary
22 course of business be “justified by the facts and circumstances of the case” to be allowed under
23 § 503(b)(2). This standard is no different from the business judgment standard under § 363(b). See
24 KEIP/KERP Ruling [Docket No. 814] at 5 (collecting cases). Courts presume that “an incentive
25 plan established post-petition by a debtor-in-possession for the benefit of senior management is in
26 the ordinary course of the Debtors’ business.” *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 798
27 (Bankr. D. Del. 2007) (cited by KEIP/KERP Ruling at 5).
28

1 Additionally, the Court may authorize the Debtors to implement the Amendment under
2 § 363(b)(1). Section 363(b)(1) provides that “[t]he trustee, after notice and a hearing, may use, sell,
3 or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C.
4 § 363(b)(1). The use, sale or lease of property of the estate, other than in the ordinary course of
5 business, is authorized when a “sound business purpose” justifies such action. *See, e.g., In re*
6 *Pomona Valley Med. Group, Inc.*, 476 F.3d 665, 670 (9th Cir. 2007).

7 The Ninth Circuit applies the business judgment rule for debtors in possession because
8 “courts are no more equipped to make subjective business decisions for insolvent businesses than
9 they are for solvent businesses.” *Id.* “In evaluating the [business] decision, the bankruptcy court
10 should presume that the debtor-in-possession acted prudently, on an informed basis, in good faith,
11 and in the honest belief that the action taken was in the best interests of the bankruptcy estate.” *Id.*
12 The Court should only override the Debtors’ business decision if the evidence shows it “is so
13 manifestly unreasonable that it could not be based on sound business judgment, but only on bad
14 faith, or whim or caprice.” *Id.*

15 The Debtors have determined, utilizing their reasonable business judgment, that the
16 Amendment is necessary to maximize value through the SGM Sale, and, therefore, it is in the best
17 interest of the Debtors’ creditors and estates. The Amendment should be approved pursuant to
18 §§ 503(b)(2), 503(c)(3), and 363(b).

19 **B. The KEIP/KERP Motion & Amendment Satisfies the *Dana* Factors**

20 In the KEIP/KERP Motion, the Debtors analyzed and satisfied the *Dana* factors, which are:
21 (i) whether the plan calculated to achieve the desired performance; (ii) whether the cost of the plan
22 is reasonable in the context of the debtor’s assets, liabilities and earning potential; (iii) whether the
23 scope of the plan is fair and reasonable; (iv) the due diligence efforts of the debtor in investigating
24 the need for a plan and which key employees need to be incentivized; and (v) whether the debtor
25 received independent counsel in performing due diligence in creating and authorizing the incentive
26 compensation. *See Dana Corp.*, 358 B.R. at 576–77. *See KEIP/KERP Mot.* at 16-23. Here, the
27 Amendment satisfies the *Dana* Factors.
28

1 **First**, the Amendment will achieve the desired performance because it will properly
2 incentivize the Amendment Employees to remain through a Closing. *In re Am. Eagle Energy Corp.*,
3 2016 WL 3573952, at *4 (Bankr. D. Colo. June 23, 2016) (approving KEIP) (“the Court concludes
4 that the driving factor incentivizing [the participants] to stay and perform [through the KEIP] was
5 to complete a sale of the oil producing assets that would maximize their value to the estate”). In
6 fact, case circumstances beyond the control of the Amendment Employees necessitate the
7 Amendment.

8 Amendments to KEIPs that are caused by governmental delays are proper and have been
9 approved. For example, in the *Lightsquared* bankruptcy, the debtors obtained approval of a key
10 employee incentive plan (the “Lightsquared KEIP”), and then experienced a “delayed timeline
11 dictated by various unforeseen complexities and circumstances that [arose] in the Chapter 11
12 Cases,” notably regulatory delays from the Federal Communications Commission. *See Supplement*
13 *and Reply in Support of Lightsquared’s Motion for Entry of Order Authorizing Lightsquared to*
14 *Modify and Extend Existing Key Employee Incentive Plan*, Case No. 12-12080, Docket No. 2181,
15 at **3-7 (Bankr. S.D.N.Y. Mar. 5, 2015).⁴ The debtors requested that the Bankruptcy Court for the
16 Southern District of New York modify the original key employee incentive program to correspond
17 with the delayed timeline. *See id.* The debtors argued that they needed the amendment to “continue
18 to actively manage [their] operations and ongoing business relationships in a fiscally prudent
19 manner [to reach] the effective date of the Plan.” *Id.* at *6. The Court granted the amendment and
20 “authoriz[ed] LightSquared to modify and extend LightSquared’s existing Key Employee Incentive
21 Plan to accommodate the current facts and circumstances of the Chapter 11 Cases.” *See Order*
22 *Authorizing LightSquared to Modify and Extend Existing Key Employee Incentive Plan*, Case No.
23 12-12080, Docket No. 2274 at *1 (Bankr. S.D.N.Y. Mar. 27, 2015) (the “Lightsquared Order”).⁵
24 Here, likewise, the existing facts and circumstances of the Cases and the SGM Sale, unforeseen
25 when the KEIP was originally sought, warrant the Amendment.

26
27
28 ⁴ Attached as **Exhibit “C”**.

⁵ Attached as **Exhibit “D”**.

Given the complexities of the SGM Sale, the targeted 2019 Closing date is not a *fait-accompli*, further supporting this factor. *In re Residential Capital, LLC*, 478 B.R. 154, 171–73 (Bankr. S.D.N.Y. 2012) (interpreting *In re Velo Holdings Inc.*, 472 B.R. 201, 211 (Bankr. S.D.N.Y. 2012)). This is especially appropriate where the Amendment Employees “must work diligently with the Debtors’ [professionals to] work with proposed buyers [in] responding to due diligence requests and providing business and financial information.” *In re Velo Holdings Inc.*, 472 B.R. at 211.

Also, the Amendment will have the effect of incentivizing the Amendment Employees to continue to work diligently towards the Closing. *See In re Global Home Prods. LLC*, 369 B.R. 778, 786 (Bankr. D. Del. 2007) (finding that proposed incentive plans were “primarily incentivizing and only coincidentally retentive” and noting, “[t]he fact that . . . all compensation has a retention element d[id] not reduce the Court’s conviction” that the debtors’ primary goal in approving the incentive plans was “to create value by motivating performance”); *see also Dana Corp.*, 358 B.R. at 571 (“because a plan has some retentive effect does not mean that the plan, overall, is retentive rather than incentivizing in nature.”).

The Debtors need the Amendment Employees to be incentivized during the final days of their Remaining Hospital sale. Whether the Remaining Hospitals continue to be sold in an orderly and lucrative manner hinges, in no small part, on the efforts of the Amendment Employees. The amended contingency of a later Closing is properly incentivizing and fairly reflects the reality of the Cases and SGM Sale. *See* Lightsquared Order.⁶

Second, the cost and scope of the Amendment is reasonable, with the Debtors continuing to motivate the Amendment Employees with a total bonus amount already approved by this Court and requesting permission to pay a maximum amount of \$381,505, if there is a 2019 Closing. *See* KEIP/KERP Ruling; KEIP/KERP Order. This is especially reasonable compared to the stakes of the SGM Sale Closing (\$610 million). Further, as this Court previously considered, the amount to be paid to the Amendment Employees — 15% of their salary — for a timely sale is in line with

⁶ *In re Alpha Nat. Res., Inc.*, 546 B.R. 348, 359–60 (Bankr. E.D. Va. 2016), *aff’d sub nom. United Mine Workers of Am. 1974 Pension Plan & Tr. v. Alpha Nat. Res., Inc.*, 553 B.R. 556 (E.D. Va. 2016) (“Notably, the [participants] can earn a ‘target’ level payout for confirmation of a Chapter 11 plan or a sale of substantially all of the Debtors’ assets. However, this payout is only earned if the sale or confirmation takes place prior to June 30, 2016.”).

1 what courts have approved. *See* Declaration of Christopher J. Kearns filed in support of the
2 KEIP/KERP Motion.⁷

3 ***Third***, the scope of the Amended Plan is fair and reasonable, as it is narrowly tailored and
4 helps to fulfill the goal of maximizing value to stakeholders. While all of the Debtors' employees
5 play a role in the Debtors' overall financial success, the Debtors limited the Amendment to those
6 seven key employees (a tiny fraction of the Debtors' current, total workforce) who manage the
7 Remaining Hospitals and who are critical to (a) the Debtors' ability to operate the Hospitals through
8 the Closing, (b) preserve the value of the Debtors' Remaining Hospitals (as required under the
9 APA), and (c) deliver quality patient care. *See* Current Adcock Declaration, ¶¶ 13, 17 and 18.

10 ***Fourth*** and ***Fifth***, the Debtors have performed all necessary due diligence and obtained
11 informed, independent advice from their professionals with respect to the Amendment. *See* Current
12 Adcock Declaration, ¶¶ 12.

13 **V.**

14 **CONCLUSION**

15 **WHEREFORE**, the Debtors respectfully request that the Court enter an order (i) granting
16 the Motion, (ii) approving the Amendment, and (iii) grant to the Debtors such other and further
17 relief as the Court may deem just and proper.

18 Dated: October 4, 2019

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19
20
21 By /s/ Tania M. Moyron
22 Tania M. Moyron

23 Attorneys for Debtors
24
25
26

27 ⁷ *In re Allied Holdings, Inc.*, 337 B.R. 716, 718 (Bankr. N.D. Ga. 2005) (approval of bonus up to 150% of base salary);
28 *In re Alpha Nat. Res., Inc.*, 546 B.R. at 362 (Bankr. E.D. Va.) (KEIP of 60-175% of salary approved tied to sale proceeds,
et. al.); *In re Velo Holdings Inc.*, 472 B.R. at 211 (approving payment of 1% of sale proceeds to single executive under
KEIP).

DECLARATION OF RICHARD G. ADCOCK

I, Richard G. Adcock, declare that if called on as a witness, I would and could testify of my own personal knowledge as follows:

1. I make this declaration (the “Declaration”) in support of the *Debtors Motion for Entry of Order Amending Key Employee Incentive Plan* (the “Motion”).⁸

2. I am the Chief Executive Officer (“CEO”) of Verity Health System of California, Inc. (“VHS”). I became VHS’ CEO effective January 2018. Prior thereto, I served as VHS’ Chief Operating Officer (“COO”) beginning in August 2017. In my roles as COO and CEO at VHS, I have become intimately familiar with all aspects of VHS and its above-captioned affiliates who have also filed for bankruptcy protection (collectively the “Debtors,” and each a “Debtor”) as well as those affiliated entities that are not in bankruptcy.

3. I have worked for more than 14 years in the healthcare arena. During this period, I have accumulated extensive senior level experience in the areas of not-for-profit healthcare, especially in healthcare delivery, hospital acute care services, health plan management, product management, acquisitions, integrations, population health management, budgeting, disease management and medical devices. I also have meaningful experience in other related areas, including human resources and personnel management.

4. My background and familiarity with the Debtors’ day-to-day operations, business and financial affairs, and the circumstances leading to the commencement of these chapter 11 bankruptcy cases are set forth more fully in my *Declaration filed in Support of Emergency First-Day Motions* [Docket No. 8] on August 31, 2018 (the “Petition Date”), and incorporated by reference into this Declaration.

5. I also fully incorporate my previous declaration in support of the *Debtors’ Motion and Memorandum of Points and Authority in Support of Approval of Debtors’ Key Employee Incentive Program and Key Employee Retention Program* [Docket No. 631].

⁸ Unless otherwise defined, capitalized terms used herein shall have the same meaning as in the Motion.

A. The Current Entity KEIP and its Connection to the Sale Process

6. Currently, the Entity KEIP is tied to two metrics: (1) the Debtors meeting a cash flow target, based on adherence to the DIP budget (“Net Cash Flow Target”) measured through the earlier of (i) the date of termination without cause, (ii) complete repayment of the DIP loan, or (iii) June 30, 2019 (“DIP Measure Date”) and (2) the timing of when Debtors close the sale of the employees’ respective hospital employer (the “Closing Metric”). The Debtors met the Net Cash Flow Target on the DIP Measure Date, and all Entity KEIP Participants were duly paid the required portion of their bonuses.

7. As to the Closing Metric, each Amendment Employee’s potential remaining maximum KEIP payment is capped at an additional 3% for a closing between October 1, 2019 and before December 31, 2019, with no additional bonus to be paid for any later sale.

8. Due to the significant efforts of the Debtors’ key employees, who made themselves available for diligence and transition issues with the buyer and who helped maintain the going-concern value of those two hospitals, the SCC Sale closed on February 28, 2019, resulting in \$235 million in sales proceeds to the Debtors’ estate.

9. The Entity KEIP Participants employed by OCH and SLRH received the maximum bonus tied to the timing of that sale (15% of salary), because the SCC Sale closed before the Closing Metric date of March 31, 2019.

B. The Amendment Employees and the Closing

10. The Closing has not yet occurred. The AG took the full time to issue a decision regarding the SGM Sale (September 25, 2019). The Debtors filed an emergency motion on September 30, 2019 challenging the AG’s decision [Docket No. 3188], and the Court has set a hearing date on the Motion for October 15, 2019 [Docket No. 3193]. If the Closing occurs before December 31, 2019, the Amendment Employees would only be entitled to receive a remaining bonus of 3% of their salary (as opposed to their OCH and SLRH counterparts who received an additional 15% for the closing of the SCC Sale), despite the fact that they have performed longer than other Entity KEIP Participants to preserve the value of the Remaining Hospitals.

11. Though the Debtors have and continue to pay all their employees timely and in the ordinary course, including scheduled wage increases and PTO, the Debtors face a material attrition risk and morale concerns with their Amendment Employees. For instance, Seton Medical Center has lost its Chief Financial Officer and Chief Nursing Officer (representing two of its top three executives).

C. The Necessity of the Amendment to Incentivize the Amendment Employees

12. With the goal of incentivizing the Amendment Employees, the Debtors incorporated and reviewed their previous KEIP analysis and continued to conduct due diligence and to work with their advisors to assess market comparable bonuses and structures as part of developing the Amendment.

13. While all of the Debtors' employees play a role in the Debtors' overall financial success, the Debtors limited the Amendment to those seven key employees (a tiny fraction of the Debtors' current, total workforce) who run the Remaining Hospitals and who are critical to (a) the Debtors' ability to operate the Hospitals through the Closing, (b) preserve the value of the Debtors' Remaining Hospitals (as required under the APA), and (c) deliver quality patient care.

14. The Amendment is needed to incentivize the Amendment Employees, whose efforts and expertise are integral to preserving the Debtors complex assets and closing the SGM Sale, and who have no culpability for the delay of the sale of their employers.

15. The Debtors seek the Amendment to modify the KEIP, so that, if the SGM Sale occurs before December 31, 2019, the Amendment Employees will receive a bonus of 15% of their salary instead of the current amounts of 3%. Otherwise, the Court-approved KEIP terms will remain in place. A true and correct redline of the KEIP reflecting the Amendment is attached to the Motion as **Exhibit "A."**

16. Compared to the Current KEIP, the Amendment represents an incremental cost of \$305,204. If the sale had closed by March 31, 2019, the bonuses would have totaled \$462,975, which is comprised of the bonuses that would have been paid to nine Entity KEIP Participants. Thus, the Debtors had already anticipated paying these bonuses and would, in fact, pay less given that there are now seven employees who are Entity KEIP Participants (*i.e.*, the Amendment

1 Employees). Based on the foregoing, coupled with the considerations discussed above, the Debtors,
2 in their business judgment, have determined that the Amendment's price is worth paying to preserve
3 morale and incentivize the Amendment Employees to help facilitate the Closing of the \$610 million
4 SGM Sale.

5 17. The amended contingency of a later Closing to the Entity KEIP is properly
6 incentivizing and fairly reflects the reality of the Cases and SGM Sale.

7 I declare under penalty of perjury that, to the best of my knowledge and after reasonable
8 inquiry, the foregoing is true and correct.

9 Executed this 4th day of October 2019, at Los Angeles, California.

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11 RICHARD G. ADCOCK
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EXHIBIT A

EXHIBIT A

VERITY

KEY EMPLOYEE INCENTIVE PLAN (“KEIP”)

1. Purpose

The KEIP is intended to provide incentives for certain employees of the Debtors to achieve a Sale in connection with the Debtors’ Chapter 11 Cases for the benefit of the Debtors’ estates and stakeholders.

2. Definitions

(a) “Approved Budget” means that certain budget approved by the Final DIP Order, subject to adjustment for any waivers granted, and as may be amended from time to time, in each case with the consent of the DIP Agent and Lenders.

(b) “Bankruptcy Code” means title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.*

(c) “Bankruptcy Court” means the United States Bankruptcy Court for the Central District of California.

(d) “Cause” shall mean (i) a KEIP Participant’s failure to materially perform the duties for which he or she is employed, (ii) a KEIP Participant’s willful violation of a material Debtors’ policy, (iii) a KEIP Participant’s commission of any act or acts of fraud, embezzlement, dishonesty or other willful misconduct, (iv) a KEIP Participant’s material breach of any of his or her obligations under any written agreement or covenant with the Debtor that employs he or she, (v) any willful or reckless disclosure by a KEIP Participant—or otherwise caused by a KEIP Participant—of confidential, proprietary, or otherwise nonpublic information concerning, without limitation, the Debtors, their affairs, their businesses, the Chapter 11 Cases, and/or all matters related to the Sale Process or Chapter 11 Plan, or (vi) an act of dishonesty on the part of the KEIP Participant resulting or intended to result, directly or indirectly, in his or her gain for personal enrichment at the expense of the Debtors.

(e) “Chapter 11 Cases” means those certain jointly administered cases under chapter 11 of the Bankruptcy Code currently pending in the United States Bankruptcy Court, Central District of California, Los Angeles Division, under Lead Case No. 18-20151.

(f) “Chapter 11 Plan” means any plan of reorganization or liquidation filed by the Debtors in the Chapter 11 Cases, including all exhibits thereto and as amended, supplemented, or otherwise modified from time to time.

(g) “Code” means the Internal Revenue Code of 1986, as it may be amended from time to time, including regulations and rules thereunder and successor provisions and regulations and rules thereto.

(h) “Debtor” or “Debtors” means one or more debtor and debtor in possession, respectively, in these Chapter 11 Cases.

- (i) “DIP Agent” shall be as defined in the Final DIP Order or, if applicable, the DIP Credit Agreement.
- (j) “DIP Credit Agreement” means that certain debtor in possession credit agreement attached to the Final DIP Order.
- (k) “DIP Loan” means, at any relevant time, the outstanding obligations to Lenders under the Debtor’s debtor-in-possession financing approved by the Bankruptcy Court on a final basis pursuant to the Final DIP Order.
- (l) “DIP Measure Date” means the earlier date of termination without cause or complete repayment of the DIP Loan or June 30, 2019.
- (m) “Disability” means “disabled” within the meaning of Section 409A of the Code and the regulations issued thereunder.
- (n) “Effective Date” shall have the meaning set forth in Section 7(b).
- (o) “Entity KEIP Participant” and “Entity KEIP Participants” means one or more of the individuals identified on the Entity KEIP Participant List.
- (p) “Entity KEIP Participant List” means Schedule 2 as attached hereto as may be modified and amended from time to time.
- (q) “Entity KEIP Potential” means the maximum amount of 30% of the annual salary of an Entity KEIP Participant may earn as KEIP Payments under Section 5(b).
- (r) “Final DIP Order” means the order entered by the Bankruptcy Court on October 4, 2018 approving the DIP Loan (Docket 409) and budget that is not subject to a stay pending appeal.
- (s) “KEIP” means this Key Employee Incentive Plan.
- (t) “KEIP Incentive Pool” shall have the meaning set forth in Section 6.
- (u) “KEIP Participant” and “KEIP Participants” means one or more of the individuals identified as participating in this Plan on a KEIP Participant List.
- (v) “KEIP Participant Lists” means Schedule 1 and Schedule 2, as either or both may be modified and amended from time to time.
- (w) “KEIP Payments” shall have the meaning set forth in Section 5.
- (x) “Lenders” shall have the same meaning as that term is defined in the DIP Credit Agreement.
- (y) “Petition Date” means August 31, 2018.
- (z) “Plan Effective Date” means the date upon which the Chapter 11 Plan goes in effect in accordance with the terms thereof.
- (aa) “Release Date” shall have the meaning set forth in Section 8.

(bb) “Reorganized Debtor” and “Reorganized Debtors” means one or more Debtor, respectively, as it/they exit(s) as of the Plan Effective Date.

(cc) “Sale” means the sale of assets or equity in one or more Debtor.

(dd) “Sale Closing Date” shall have the meaning set forth in Section 5(b)(ii).

(ee) “Sale Proceeds” means the total consideration attributable to any Sale; including realization from any excluded assets related to such Sales and/or the assumption of liabilities, whether received before or after the Plan Effective Date.

(ff) “Section 5 Conditions” and “Section 5 Condition” means one or more of the Conditions set forth in Section 5(a) and 5(b).

(gg) “Section 5 Trigger Date” and “Section 5 Trigger Dates” means, for Section 5(a) the Plan Effective Date, for Section 5(b)(i) the DIP Measure Date and for Section 5(b)(ii) the Sale Closing Date.

(hh) “VHS” means Verity Health System of California, Inc.

(ii) “VHS Board” means the Board of Directors for VHS.

(jj) “VHS KEIP Participant” and “VHS KEIP Participants” means one or more VHS KEIP Participants identified on the VHS KEIP Participant List.

(kk) “VHS KEIP Participant List” means Schedule 1 attached hereto as may be modified and amended from time to time.

(ll) “VHS KEIP Potential” means the maximum amount set forth in Schedule 1 that a VHS KEIP Participant may earn as KEIP Payments under Section 5(a).

3. Administration

Subject to the terms of this KEIP, the VHS Board shall have exclusive authority to interpret, operate, manage and administer the KEIP in accordance with its terms and conditions. The VHS Board shall have full discretionary authority in all matters related to the discharge of their respective responsibilities and the exercise of their respective authority under the KEIP. All determinations, decisions, actions and interpretations made or taken by the VHS Board with respect to the KEIP shall be final, conclusive and binding on all KEIP Participants and all other persons having or claiming to have any right or interest in or under the KEIP. The VHS Board may consider such factors as it deems relevant to making or taking such decisions, determinations, actions and interpretations, including the recommendations or advice of any director, officer or employee of the Debtor or an affiliate and such attorneys, consultants and accountants as the VHS Board may select. A KEIP Participant may contest a decision or action by the VHS Board with respect to such KEIP Participant only on the grounds that such decision or action was arbitrary or capricious or was unlawful, and any review of such decision or action shall be limited to determining whether the VHS Board’s decision or action was arbitrary or capricious or was unlawful.

4. Award Opportunities

Each KEIP Participant will be eligible to receive a payment from the KEIP Incentive Pool as described in Section 6.

4. KEIP Payments

Subject to the limitations set forth in this KEIP, the Debtors or the Reorganized Debtors (as applicable) shall make payments to the KEIP Participants listed on the KEIP Participant Lists, in the manner and in the amounts as set forth below (collectively, the “KEIP Payments”):

- (a) VHS KEIP Participants: On the Plan Effective Date (or within 10 days of any Sale Proceeds received after the Plan Effective Date), in the event that Sale Proceeds total at least \$300 million,
 - (i) two participants, [REDACTED], if they are employed, will receive in addition to his or her annual contractual compensation, an amount equal to at least 20% of his or her VHS KEIP Potential (for the first \$300 million), which increases by an additional .000001% for every \$5 in Sales Proceeds above \$300 million and is capped at 150% of the VHS KEIP Potential. By way of examples, if a) Sale Proceeds total \$299 million, a KEIP Participant will receive 0%, b) Sale Proceeds total \$500 million, such a KEIP Participant will receive a KEIP Payment equal to 60% of his or her VHS KEIP Potential; c) Sales Proceeds total \$700 million, such a VHS KEIP Participant will receive a VHS KEIP Payment equal to 100% of his or her VHS KEIP Potential; and d) Sales Proceeds total or exceed \$950 million, such a VHS KEIP Participant will receive a VHS KEIP Payment equal to 150% of his or her VHS KEIP Potential; and
 - (ii) any other VHS KEIP Participant who is then employed, will receive, in addition to his or her annual contractual compensation, an amount equal to at least 10% of his or her VHS KEIP Potential (for the first \$300 million), which increases by an additional .0000005% for every \$5 in Sales Proceeds above \$300 million and is capped at 75% of the VHS KEIP Potential. By way of examples, if a) Sale Proceeds total \$299 million, a KEIP Participant will receive 0%, b) Sale Proceeds total \$500 million, such a KEIP Participant will receive a KEIP Payment equal to 30% of his or her VHS KEIP Potential; c) Sales Proceeds total \$700 million, such a VHS KEIP Participant will receive a VHS KEIP Payment equal to 50% of his or her VHS KEIP Potential; and d) Sales Proceeds total or exceed \$950 million, such a VHS KEIP Participant will receive a VHS KEIP Payment equal to 75% of his or her VHS KEIP Potential.
- (b) Entity KEIP Participants. Each Entity KEIP Participant listed on Schedule 2 is entitled to and shall receive, in addition to his or her contractual compensation, the following:

(i) 50% of the Entity KEIP Potential within ten (10) business days of the DIP Measure Date if the aggregate Net Cash Flow as forecasted in the Approved Budget is met (within +/- 7.5% of the total amount of the Approved Budget);

(ii) ~~up to~~ 50% of the Entity KEIP Potential within ten (10) business days after the closing of a sale of assets in the Debtor-for whom such KEIP Participant works as listed on Schedule 2, if the applicable closing occurs by December 31, 2019, (the "Sale Closing Date"). in the following non-aggregated percentages:

~~(A) — 50% if sale occurs by March 31, 2019;~~

~~(B) — 36.67% if sale occurs by June 30, 2019;~~

~~(C) — 25% if sale occurs by September 30, 2019; or~~

~~(D) — 10% if sale occurs by December 31, 2019.~~

By way of example, if the conditions under 5(b)(i) and 5(b)(ii)~~(C)~~ are met, Entity KEIP Participant shall receive 1) 50% of the Entity KEIP Potential within ten (10) business days of the DIP Measure Date and 2) 5025% of the VHS Entity Level KEIP Potential within ten (10) business days of the Sale Closing Date.

6. KEIP Incentive Pool. The Debtors shall fund the KEIP Incentive Pool up to an aggregate amount of \$5,100,000 through DIP financing loans or permitted use of Cash Collateral (as that term is defined in the Final DIP Order and which amount is designated in the Approved Budget). Any amount needed to satisfy the Entity KEIP Potential and/or the VHS KEIP Potential in excess of \$5,100,000 will be paid from Sale Proceeds.

Notwithstanding the above, and subject to Section 7(b) and (c) of this KEIP, if any KEIP Participant's employment with the Debtor ends or terminates for any reason (other than for Cause or death or Disability of the KEIP Participant, as set forth under Section 7(b) and (c), respectively), prior to the occurrence of an applicable Section 5 Condition, the unearned portion of the KEIP Incentive Pool applicable to such KEIP Participant, shall be reallocated to the KEIP Incentive Pool, or allocated in accordance with the Approved Budget by the VHS Board without further approval of the Bankruptcy Court.

7. Termination of Employment

(a) Subject to Section 7(b) and (c), any amount attributable to a not yet satisfied Section 5 Condition shall be forfeited by the KEIP Participant in the event a KEIP Participant's employment with a Debtor terminates for any reason (including, without limitation, if such KEIP Participant resigns, quits, or otherwise ends his or her employment with a Debtor) prior to the satisfaction of each of the Section 5 Conditions.

(b) If a KEIP Participant's employment with a Debtor is terminated without Cause, then such KEIP Participant shall be entitled to receive the KEIP Payments that would have been earned under the KEIP had such KEIP Participant been employed through the occurrence of the Section 5 Conditions on the Section 5 Trigger Dates as set forth in Section 5.

(c) If a KEIP Participant's employment with a Debtor is terminated due to death or Disability (as determined by the Debtors or the Reorganized Debtors, as applicable), prior to the occurrence of a Section 5 Trigger Date, then such KEIP Participant shall be entitled to receive, in addition to the amount earned under any satisfied Section 5 Condition: (i) any KEIP Payments that would have been earned under the yet to occur Section 5 Trigger Date (the "Effective Date"), divided by (ii) the number of days from the Petition Date through the occurrence of the Effective Date, multiplied by (iii) the number of days from the Petition Date through the occurrence of the Effective Date during which such KEIP Participant was employed by the Debtor.

8. Release

All payments under the KEIP shall be contingent upon, and no payment under the KEIP shall be made to a KEIP Participant (or if deceased, the representative of such KEIP Participant's estate) unless the KEIP Participant (or his or her representative) has duly executed a full release of known and unknown claims that such KEIP Participant may have against the Debtors or the Reorganized Debtors in a form determined appropriate by the Debtors or the Reorganized Debtors (as applicable), which release has become effective and has not been revoked as of the first Section 5 Trigger Date as to which payment is made to such KEIP Participant. To the extent executed in connection with a Section 5 Trigger Date prior to the Plan Effective Date, the release will (i) require such participant's signature to be reaffirmed by the relevant KERP Participant, and made applicable to all known and unknown claims accruing after the relevant Section 5 Trigger Date, on the Plan Effective Date; and (ii) as reaffirmed, become effective and non-revocable not later than the date that is ten (10) days following the Plan Effective Date.. Such release will include, but not be limited to, (i) any claim against the Debtors or the Reorganized Debtors with respect to such employee's employment with any Debtor (other than accrued and unpaid salary, benefits, expense reimbursement, vacation and any indemnification or any rights to and under insurance) and (ii) if applicable, any claim, right, or interest to any previously unpaid amounts earned or accrued with respect to any previous plans, agreements, or policies related to retention, severance, bonuses (but not including payments that are made in ordinary course for referral of new employees which is sometimes called a referral bonus), or incentives. In the event that any release is not executed by the KEIP Participant (or if deceased, the representative of such KEIP Participant's estate) in accordance with this Section, any payments under this KEIP will be forfeited. This provision is without prejudice to the KEIP Participant seeking or receiving releases, waivers and exculpation under any Chapter 11 Plan.

9. Section 409A

The KEIP is intended to comply with, or satisfy an applicable exemption from, Section 409A of the Internal Revenue Code of 1986, as amended, and the KEIP shall be administered and interpreted in accordance with such intention.

10. Miscellaneous

(a) The KEIP shall constitute an unfunded, unsecured liability of the Debtor to make payments in accordance with the provisions of the KEIP, and no individual shall have any security interest, ownership interest, or other interest in any assets of the Debtor or the Reorganized Debtor (as applicable) in connection with the KEIP. Neither the establishment of the KEIP nor any obligation of the Debtor or the Reorganized Debtor (as applicable) to make payments under the KEIP shall be deemed to create a trust or a principal-agent relationship. This KEIP does not

constitute a term or condition of employment and no KEIP Participant shall have any right to receive payments hereunder, except to the extent all conditions relating to the receipt of such payments have been satisfied.

(b) Nothing in the KEIP shall be construed or interpreted as giving any KEIP Participant the right to be employed or retained by a Debtor or a Reorganized Debtor (as applicable) for any period or otherwise or impair the right of the Debtors or the Reorganized Debtors (as applicable) to control its employees or to terminate the services of any employee at any time.

(c) Amounts payable under the KEIP shall not be considered wages, salaries, or compensation under any employee benefit plan, except pursuant to the written terms of the KEIP.

(d) The Debtors or the Reorganized Debtors (as applicable) shall be entitled to withhold from any amount due and payable by the Debtors or the Reorganized Debtors (as applicable) to any KEIP Participant (or secure payment from such KEIP Participant in lieu of withholding) the amount of any withholding or other tax due from the Debtor or the Reorganized Debtor (as applicable) with respect to any amount payable to such KEIP Participant under this KEIP.

(e) If a KEIP Participant becomes entitled to any payments under the KEIP, and if at such time such KEIP Participant has outstanding any debt, obligation, or other liability representing an amount owing to a Debtor or a Reorganized Debtor (as applicable) (whether or not such liability is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, or equitable), then the Debtors or the Reorganized Debtors (as applicable) may offset such amount against the amount otherwise distributable to such KEIP Participant to the extent permitted by applicable law.

(f) No person otherwise eligible to receive any payment under the KEIP shall have any rights to pledge, assign, transfer, sell, or otherwise dispose of all or any portion of such payments, either directly or by operation of law, including, without limitation, by execution, levy, garnishment, attachment, pledge, or bankruptcy. If a KEIP Participant is not living at the time any payments are otherwise payable to him or her in accordance with the KEIP, such payments shall be paid as designated by the KEIP Participant by will or by the laws of descent and distribution.

(g) To the extent not inconsistent with any order of the Bankruptcy Court approving the KEIP, the KEIP made and actions taken thereunder shall be governed by and construed in accordance with the laws of the State of California, without reference to the principles of conflict of laws, except as superseded by applicable federal law. So long as the Bankruptcy Court has jurisdiction with respect to the Chapter 11 Case, any dispute arising under the KEIP shall be resolved by the Bankruptcy Court.

Schedule 1

(KEIP Participant List of KEIP Participants Employed Solely by VHS)

[FILED UNDER SEAL]

Schedule 2

(KEIP Participant List of VHS Entity Level KEIP Participants)

[FILED UNDER SEAL]

EXHIBIT B

EXHIBIT B

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, November 13, 2018

Hearing Room 1568

10:00 AM

2:18-20151 Verity Health System of California, Inc.

Chapter 11

#34.00 HearingRE: [631] Motion /Notice of Motion For Entry of Order Authorizing and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan; Memorandum of Points and Authorities In Support Thereof; Declarations of Richard G. Adcock and Christopher J. Kearns Filed Concurrently Herewith (Maizel, Samuel)

Docket 631

Matter Notes:

11/13/2018

The tentative ruling will be the order.
Party to lodge order: Movant

POST PDF OF TENTATIVE RULING TO CIAO

Tentative Ruling:

11/9/2018

For the reasons set forth below, the Motion is GRANTED in its entirety.

Pleadings Filed and Reviewed:

- 1) Notice of Motion and Debtors' Motion for Entry of Order Authorizing and Approving (I) Key Employee Incentive Plan, and (II) Key Employee Retention Plan [Doc. No. 631] (the "Motion")
- 2) Order Granting Debtors' Motion for Entry of an Order Sealing Employee Information and Denying Evidentiary Objections Thereto [Doc. No. 735]
- 3) Official Committee of Unsecured Creditors' Response to [Motion] [Doc. No. 739]
- 4) United States Trustee Response to [Motion] [Doc. No. 769]

I. Facts and Summary of Pleadings

On August 31, 2018, Verity Health Systems of California ("VHS") and certain of

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CONT... Verity Health System of California, Inc.

Chapter 11

its subsidiaries (collectively, the “Debtors”) filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On August 31, 2018, the Court entered an order granting the Debtors’ motion for joint administration of the Debtors’ Chapter 11 cases. Doc. No. 17.

The Debtors seek approval of a Key Employee Retention Plan (“KERP”) and Key Employee Incentive Plan (“KEIP”). On November 1, 2018, the Court entered an order authorizing the Debtors to file under seal certain information in support of the Motion. *See* Order Granting Debtors’ Motion for Entry of an Order Sealing Employee Information and Denying Evidentiary Objections Thereto [Doc. No. 735] and Final Ruling Granting Debtors’ Motion for Entry of an Order Sealing Employee Information [Doc. No. 721]. The information filed under seal (the “Confidential Information”) consists of the identity and salary of the twenty employees subject to the KERP, and the identity and salary of the twenty-five employees subject to the KEIP.

The Debtors have discussed the KERP and KEIP with the United States Trustee (the “UST”) and the Official Committee of Unsecured Creditors (the “Committee”). The concerns of the Committee and the UST have been resolved through discussions and/or certain modifications that the Debtors have agreed to make to the KERP and KEIP. There are no unresolved objections to the Motion.

The KEIP is designed to incentivize key employees to obtain the maximum sales price for the Debtors’ assets. KEIP participants are entitled to receive bonus payments, expressed as a percentage of their annual salary, if certain sale price benchmarks are achieved. The bonus payment structure varies depending upon each key employee’s envisioned role in the sale process, and was developed in consultation with outside consultants.

Two pools of employees are eligible for the KEIP: (1) key employees of VHS (the “VHS Participants”) whose assistance is required to maximize value from the sales of all of VHS’ material assets, however long that may take; and (2) key employees of one of the hospitals or Verity Medical Foundation (the “Entity Participants”), whose assistance is needed to maintain operations until the sale of the particular facility in which he or she works.

If consideration for the sales is \$950 million or more, the nine KEIP VHS Participants are eligible to receive bonus payments aggregating approximately \$5.3 million (or 0.56% of the sales consideration).

KEIP Entity Participants receive bonus payments based upon (1) performance against the DIP budget and the (2) timing of the sale of their respective employers’ business/assets (the longer the sale takes, the lower the bonus payment). The

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CONT... Verity Health System of California, Inc.

Chapter 11

maximum KEIP payment for the sixteen Entity Participants is just below \$1.6 million.

The KERP is intended to facilitate the Debtors' continued operation until its assets can be sold by encouraging certain key employees to remain employed with the Debtors. The KERP is available to twenty employees and provides a maximum potential benefit of 30% of an employees' annual salary, based upon the following criteria: 6% of annual salary for retention through December 31, 2018; 6% of annual salary for retention through March 31, 2019; and 6% of annual salary for retention through June 30, 2019, plus 12% of annual salary in the event of separation by management.

The Debtors request that all amounts earned and payable under the KEIP and KERP be afforded administrative-expense priority pursuant to §§503(b), 503(c), and 507(a). Ally Bank, the DIP Lender, supports the funding of the KEIP and KERP through DIP financing proceeds.

II. Findings and Conclusions

A. The Debtor Has Shown Sufficient Business Justification for the Incentive Programs

Section 363(b)(1) authorizes the Debtors to use property of the estate, other than in the ordinary course of business, after notice and a hearing. The Debtors are required to articulate a business justification for use of estate property outside the ordinary course of business. *Walter v. Sunwest Bank (In re Walter)*, 83 B.R. 14, 19–20 (9th Cir. BAP 1988). Whether the articulated business justification is sufficient "depends on the case," in view of "all salient factors pertaining to the proceeding." *Id.* at 19–20.

Here, the Debtors have sufficiently articulated a business justification for making the bonus payments contemplated under the KEIP and KERP. The Debtors have shown that the bonus payments are required to retain key employees who are necessary to preserve the value of the Debtors' assets.

B. Application of the Dana Corp. Factors Supports Approval of the Incentive Programs

Courts have relied upon the following factors in evaluating key employee incentive and retention plans such as those at issue here:

- 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

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incentive, is the plan calculated to achieve the desired performance? (emphasis added)

- 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?

In re Dana Corp., 358 B.R. 567, 576–77 (Bankr. S.D.N.Y. 2006).

The factors set forth in *Dana Corp.* are met here. First, the KEIP appropriately incentivizes participants by awarding bonuses to employees only after the Debtors achieve specific sales results. Payments under the KEIP are also tied to the efficiency of the sale, and the KEIP has been structured in a way that pushes participants to close the sale in a speedy fashion.

Second, the KEIP is reasonable in the context of the Debtors' assets, liabilities, and earning potential. The maximum payment available to the nine key executives under the KEIP amounts to less than 1% of the sales price. The Court finds that the KEIP comports with industry standards.

Third, the scope of the KEIP is fair and reasonable. The KEIP applies to only those employees whose efforts are critical to ensure a successful sale of the Debtors' assets. In addition, the KEIP has been carefully crafted to award different payments to different employees, depending upon their anticipated role in the sales process.

Fourth, the exhibits filed in support of the Motion establish that the Debtors have performed extensive due diligence in developing the KEIP and KERP. The incentive plans have been developed by the Debtors in consultation with Berkeley Research Group, the Debtors' financial advisors.

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, November 13, 2018

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

C. The Incentive Programs Meet the Requirements Imposed by §503(c)(3)

Section 503(c)(3) requires that payments to a debtor's employees outside the ordinary course of business be "justified by the facts and circumstances of the case" to be allowable as an administrative expense. The majority of courts have found that this standard is no different from the business judgment standard under §363(b). *See, e.g., Global Home Prods.*, 369 B.R. at 783-84; *In re Velo Holdings, Inc.*, 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012) (collecting cases); *In re Nobex Corp.*, 2006 WL 4063024, 2006 Bankr. (Bankr. D. Del. Jan. 19, 2006) (court concluded that section 503(c)(3) was nothing more than a reiteration of the standard under section 363 under which courts had previously authorized transfers outside the ordinary course of business based on the business judgment of the debtor).

Having found that the incentive plan payments are appropriate under §363(b)(1), the Court finds that the incentive plans also meet the standard set forth in §503(c)(3), and accordingly are allowable as an administrative expense.

III. Conclusion

Based upon the foregoing, the Motion is GRANTED in its entirety. The Debtor shall submit a conforming order, incorporating this tentative ruling by reference, within seven days of the hearing.

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Jessica Vogel or Daniel Koontz at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Party Information

Debtor(s):

Verity Health System of California,

Represented By
Samuel R Maizel
John A Moe II
Tania M Moyron

**United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, November 13, 2018

Hearing Room 1568

10:00 AM

CONT... Verity Health System of California, Inc.

Chapter 11

Claude D Montgomery
Sam J Alberts

EXHIBIT C

EXHIBIT C

Matthew S. Barr
 Steven Z. Szanzer
 Karen Gartenberg
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 (212) 530-5000

Counsel to Debtors and Debtors in Possession

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

)	
In re:)	Chapter 11
)	
LIGHTSQUARED INC., <i>et al.</i> ,)	Case No. 12-12080 (SCC)
)	
Debtors. ¹)	Jointly Administered
)	

**SUPPLEMENT AND REPLY IN SUPPORT OF LIGHTSQUARED’S
 MOTION FOR ENTRY OF ORDER AUTHORIZING LIGHTSQUARED TO
 MODIFY AND EXTEND EXISTING KEY EMPLOYEE INCENTIVE PLAN**

¹ The debtors in these Chapter 11 Cases (as defined below), along with the last four digits of each debtor’s federal or foreign tax or registration identification number, are: LightSquared Inc. (8845), LightSquared Investors Holdings Inc. (0984), One Dot Four Corp. (8806), One Dot Six Corp. (8763), SkyTerra Rollup LLC (N/A), SkyTerra Rollup Sub LLC (N/A), SkyTerra Investors LLC (N/A), TMI Communications Delaware, Limited Partnership (4456), LightSquared GP Inc. (6190), LightSquared LP (3801), ATC Technologies, LLC (3432), LightSquared Corp. (1361), LightSquared Finance Co. (6962), LightSquared Network LLC (1750), LightSquared Inc. of Virginia (9725), LightSquared Subsidiary LLC (9821), Lightsquared Bermuda Ltd. (7247), SkyTerra Holdings (Canada) Inc. (0631), SkyTerra (Canada) Inc. (0629), and One Dot Six TVCC Corp. (0040). The location of the debtors’ corporate headquarters is 10802 Parkridge Boulevard, Reston, VA 20191.

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LightSquared Inc. and certain of its affiliates, as debtors and debtors in possession (collectively, “LightSquared”) in the above-captioned chapter 11 cases (the “Chapter 11 Cases”), pursuant to sections 363 and 503 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (as amended, the “Bankruptcy Code”), file this supplement and reply (the “Supplement”) in support of *LightSquared’s Motion for Entry of Order Authorizing LightSquared To Modify and Extend Existing Key Employee Incentive Plan* [Docket No. 2065] (the “KEIP Motion” and, together with the Supplement, the “Amended Motion”),² at the direction of the special committee of the boards of directors (the “Special Committee”) for LightSquared Inc. and LightSquared GP Inc. to (a) submit to the Court certain revisions to the proposed KEIP and (b) respond to the *Objection of SP Special Opportunities, LLC to LightSquared’s Motion for Entry of Order Authorizing LightSquared to Modify and Extend Existing Key Employee Incentive Plan* [Docket No. 2124] (the “SPSO Objection”). In support of the Amended Motion, LightSquared respectfully states as follows:³

Background to Supplement

1. On February 9, 2015, LightSquared filed the KEIP Motion seeking entry of an order authorizing LightSquared to modify and extend its existing Key Employee Incentive Plan (approved on October 23, 2012) to accommodate the current facts and circumstances of the Chapter 11 Cases (the “KEIP”).

2. Since the filing of the KEIP Motion, LightSquared has discussed the proposed relief with the Office of the United States Trustee for the Southern District of New York (the “U.S. Trustee”). As a result of those discussions, LightSquared submits this

² Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the KEIP Motion.

³ As originally noted in the KEIP Motion, LightSquared will provide the Court with evidence in support of the relief requested in the Amended Motion at the scheduled hearing.

Supplement to, among other things, reflect certain agreed-upon revisions to the proposed KEIP (the “Revised KEIP”) that satisfied the U.S. Trustee’s concerns relating to the relief requested in the Amended Motion.

3. With the U.S. Trustee satisfied that the Revised KEIP complies with section 503(c) of the Bankruptcy Code, and the Plan Support Parties fully supportive of the Revised KEIP, SPSO is the only objecting party. SPSO primarily contends that the Revised KEIP must be denied as a disguised retention plan because, even though the Court previously approved the existing Key Employee Incentive Plan as appropriately incentivizing the Key Employees, the updating of certain metrics to reflect the new timing and milestones contemplated under the Plan has somehow transformed the Revised KEIP into a completely new plan with easily attainable objectives. Nothing could be farther from the truth, as the highly contentious confirmation process and constantly changing circumstances of the Chapter 11 Cases have made it clear that no prospective outcome can be considered a foregone conclusion.

4. As demonstrated in the KEIP Motion (as supplemented below),⁴ the new Incentive Objectives not only reflect an appropriate update in response to the dramatically different facts and circumstances that have transpired in the Chapter 11 Cases since the Court’s approval of the existing Key Employee Incentive Plan, but the new Incentive Objectives also embody challenging goals that will compel the Key Employees to exert diligent and dedicated efforts through the effective date of the Plan. The achievement of the new Incentive Objectives will, in turn, drive value for all of LightSquared’s stakeholders, and facilitate LightSquared’s emergence from chapter 11. In light of the foregoing, and for the reasons set forth in the KEIP Motion (as supplemented below), LightSquared respectfully submits that the Court should

⁴ LightSquared incorporates herein by reference the background, bases, and justifications for the approval of the KEIP set forth in the KEIP Motion.

overrule the SPSO Objection (which is focused solely on the Confirmation Objective and Effective Date Objective) in its entirety and enter an order approving the Revised KEIP.

Supplement to KEIP Motion

A. Revised KEIP

5. By the KEIP Motion, LightSquared, with the assistance of LightSquared's legal and financial advisors, proposed to modify its existing Key Employee Incentive Plan (approved on October 23, 2012) to enable LightSquared to motivate and incentivize the Key Employees during the final, and perhaps most critical, phase of the Chapter 11 Cases. The KEIP was specifically designed to incentivize the Key Employees to utilize their unique institutional and industry knowledge and experience, keen understanding of LightSquared's business processes and complex technical issues, and specific industry contacts and ongoing business and governmental relationships to accomplish LightSquared's restructuring goals in accordance with LightSquared's anticipated timeline for its emergence from bankruptcy, which currently is targeted to occur in the fourth quarter of 2015.

6. As a result of discussions with the U.S. Trustee, LightSquared has agreed to certain limited revisions to the KEIP as described below and as summarized in the chart attached hereto as Exhibit A:

(i) Confirmation Objective

7. As set forth in the KEIP Motion, in light of the delayed timeline dictated by various unforeseen complexities and circumstances that have arisen in the Chapter 11 Cases, LightSquared proposed to modify the current Emergence Objective to correspond with the confirmation of the Plan. In doing so, LightSquared proposed to incentivize the Key Employees with a cash bonus of 40% of their annual salary (*i.e.*, \$880,000 in the aggregate) that would be (a) earned upon the entry of an order confirming the Plan and (b) paid upon the earlier of (i) the

“Inc. Facilities Claims Purchase Date Closing Date” under the Plan and (ii) 30 days after entry of such confirmation order (provided that there is no stay of such confirmation order in effect at such time).

8. As a result of discussions with the U.S. Trustee, LightSquared agreed to (a) reduce the cash bonus on account of the Confirmation Objective from 40% to 30% of the Key Employees’ annual salary (i.e., from \$880,000 to \$660,000 in the aggregate)⁵ and (b) reallocate the foregoing difference to the Cash Preservation Objective (as discussed below).

(ii) *Cash Preservation Objective*

9. As described in the KEIP Motion, the proposed Cash Preservation Objective (a) involves an opportunity for the Key Employees to earn a cash bonus upon the measurement of LightSquared’s actual operating expense spending on September 30, 2015 or the first business day thereafter and (b) is calibrated such that the cash awards will get paid solely from the savings realized by LightSquared (i.e., the Cash Preservation Objective is self-funding). Based upon LightSquared’s agreement to modify the proposed Confirmation Objective, LightSquared and the U.S. Trustee agreed to increase each cash bonus tier in the proposed Cash Preservation Objective by 10%. As a result, each Key Employee will earn a cash award based upon the following sliding scale:

⁵ SPSO incorrectly describes the Confirmation Objective as the payment of “nearly \$900,000 [to] *each*” of the Key Employees upon the Court’s entry of an order confirming the Plan. (SPSO Objection at ¶ 11 (emphasis added).) The cash award set forth the KEIP Motion, as amended herein, is an aggregate amount to be allocated among the Key Employees. Thus, if LightSquared meets the Confirmation Objective, LightSquared would pay only a \$660,000 cash bonus to the Key Employees collectively (i.e., 30% of their annual salaries).

Cash Bonus (% of annual salary)	April 1, 2015 – September 30, 2015 Total Operating Expenses ⁶ (% of LightSquared's Consolidated Budget)	Potential Net Savings to Estates
0%	≥100%	\$0
Lesser of 55% (approx. \$1.120 million) and 80% of actual savings	95.1-99.9% (up to approx. \$2.469 million of gross savings)	From approx. \$100.00 to approx. \$1.349 million
57.5% (approx. \$1.265 million)	90-95% (approx. \$2.520 million to approx. \$5.040 million of gross savings)	From approx. \$1.255 million to approx. \$3.775 million
60% (approx. \$1.320 million)	<90% (at least approx. \$5.090 million of gross savings)	At least approx. \$3.80 million

As illustrated above, in all instances, the savings achieved for LightSquared's estates are still more than sufficient (with significant cushion) to pay any earned cash awards on account of the Cash Preservation Objective.

(iii) *Effective Date Objective*

10. By the KEIP Motion, LightSquared proposed to modify the existing KEIP by formally replacing Regulatory Objective 3 with the Effective Date Objective, which provides for a cash bonus that may be earned by the Key Employees upon LightSquared's completion of a change of control allowing for consummation of the Plan. The Revised KEIP does not contemplate any revision to the Effective Date Objective and, therefore, such objective remains a cash bonus of 40% of the Key Employees' annual salary (i.e., \$880,000 in the aggregate) that would be (a) earned upon the FCC's approval of a change of control, as set forth under, and

⁶ Operating Expenses exclude all spectrum lease costs (i.e., payments under the Inmarsat Cooperation Agreement and One Dot Six lease), capital expenses, restructuring-related costs, and extraordinary legal and regulatory expenses not previously budgeted. The Cash Preservation Objective assumes a measurement period of April 1, 2015 to September 30, 2015 and the budget figures are based on LightSquared's current forecast for all LightSquared entities filed on February 23, 2015.

pursuant to, the Plan and (b) paid within 30 days of the effective date of the Plan.

B. Revised KEIP is Incentive-Based Plan and Sound Exercise of LightSquared's Business Judgment

11. In criticizing the propriety of the Confirmation Objective and Effective Date Objective, SPSO oversimplifies the challenging tasks that await the Key Employees, implying that all that remains for LightSquared to emerge from bankruptcy is the “*waiting* a week or two for the Confirmation Order to be entered” and “*waiting* for the FCC to approve a change of control.” (SPSO Objection at ¶ 11. (emphasis added)) LightSquared and the Key Employees should only be so fortunate. As discussed in the KEIP Motion, for the Key Employees to implement the restructuring path set forth in the Plan, and thereby achieve the Confirmation Objective and Effective Date Objective, three principal things must occur: First, LightSquared must succeed in confirming the Plan. Because SPSO continues to contest every aspect of the Plan confirmation process, it remains to be seen whether the Key Employees, even as they have worked, and continue to work, tirelessly to achieve such result, will ultimately meet the Confirmation Objective.

12. Second, LightSquared must continue to actively manage its operations and ongoing business relationships in a fiscally prudent manner that will enable it to reach the effective date of the Plan. To date, the Key Employees have successfully managed LightSquared's operations in an efficient and streamlined manner to reduce LightSquared's cash requirements as much as possible. However, given the history of the Chapter 11 Cases – which have been fraught with unpredictable challenges and constantly changing facts and circumstances (all of which have been outside the Key Employees' control) – the Revised KEIP is crucial and necessary to motivate the Key Employees to continue such efforts during this final, and perhaps most critical, phase of the Chapter 11 Cases.

13. Third, LightSquared must satisfy all of the condition precedents to the consummation of the Plan, including the completion of a change of control application process with the FCC and raising sufficient capital to fund the \$1.25 billion first lien exit financing facility. Mr. Ergen himself is well aware that a successful change of control process requires more than the mere filing of an application with the FCC. Indeed, it took DISH over eleven months to obtain the FCC's approval of a change of control in connection with its acquisition of DBSD and over six months to obtain similar change of control approvals in connection with TerreStar. (See Fed. Commc'ns Comm., Order, DA 12-332 (Mar. 2, 2012).) In light of the foregoing and the attendant complex regulatory issues that may arise during the change of control process with the FCC, the Key Employees will need to perform at their highest levels to secure the FCC's approval of a change of control within the timeline proscribed under the Plan.

14. Similarly, the Key Employees will be indispensable when LightSquared and the Plan Support Parties embark on capital raising efforts – prospective lenders will rely on the Key Employees' deep institutional and industry knowledge and experience, keen understanding of LightSquared's business processes and complex technical issues, and specific industry contacts and ongoing business and governmental relationships in determining whether the exit facility constitutes a sound investment. Accordingly, LightSquared must encourage the Key Employees to complete the significant workload stemming from the final efforts associated with emerging from bankruptcy.

15. As described in greater detail in the KEIP Motion, the new Incentive Objectives were specifically designed to incentivize the Key Employees to accomplish each of the above three tasks. In fact, not only are there no other metrics that would better assist LightSquared in achieving its restructuring goals, but no other personnel could be in a position to

achieve them. Thus, LightSquared maintains that the Revised KEIP (a) provides more than a sufficient nexus between the underlying metrics of the new Incentive Objectives and the results sought to be achieved and (b) is a sound exercise of LightSquared's business judgment.

Moreover, the U.S. Trustee has advised LightSquared that the overall potential cash payout to the Key Employees under the KEIP (i.e., cash bonuses in an aggregate amount up to 130% of the Key Employees' annual salaries – approximately \$2.86 million in total) is not unreasonable considering the facts and circumstances of the Chapter 11 Cases. Thus, it appears that SPSO, as the sole objecting party to the Revised KEIP, has elected to continue its "scorch the earth" strategy by contesting every aspect of the confirmation process regardless of the relatively *de minimis* amount at stake or the reasonableness of the relief requested.

C. Revised KEIP is Reasonable and an Actual, Necessary Cost and Expense

16. In addition to all of the reasons set forth in the KEIP Motion, the Revised KEIP should be approved pursuant to section 503(c)(3) of the Bankruptcy Code for the reasons set forth in the KEIP Motion and also because the Revised KEIP is a reasonable and an actual, necessary cost and expense to the continued operation of LightSquared's businesses and a successful restructuring. Although, in the KEIP Motion, LightSquared (a) evaluates the KEIP in terms of the business judgment standard under sections 363(b) and 503(c)(3) of the Bankruptcy Code and (b) asserts that sections 503(c)(1) and 503(c)(2) of the Bankruptcy Code do not apply to the KEIP because it is an incentive-based plan, LightSquared respectfully submits herein that the Revised KEIP is not just a sound exercise of LightSquared's business judgment, but also a reasonable and an actual and necessary step to ensuring LightSquared's successful emergence from chapter 11.

17. Section 503(b)(1)(A) of the Bankruptcy Code provides that claims allowable as administrative expenses, which the awards to the Key Employees under the Revised

KEIP would constitute, must be “actual, necessary costs and expenses of preserving the estate.”

11 U.S.C. § 503(b)(1)(A). For a claim to be “actual” and “necessary,” it must arise from a

transaction with a debtor and directly and substantially benefit such debtor’s estate. See

4 COLLIER ON BANKRUPTCY 503.06 (Alan N. Resnick & Henry J. Somme eds., 16th ed. 2014).

LightSquared believes the Revised KEIP is (a) actual, (b) reasonable, and (c) necessary, in that it will substantially benefit LightSquared’s estates.

18. As set forth in detail in the KEIP Motion, an application of the Dana Corp. factors demonstrates that the Revised KEIP is (a) reasonable in terms of the objectives it seeks to achieve, its cost, and its scope and (b) necessary to the preservation of LightSquared’s estates. See In re Dana Corp., 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006).

19. LightSquared respectfully submits that the Revised KEIP is reasonable and an actual, necessary cost and expense to LightSquared’s continued operations and successful restructuring and is in the best interests of LightSquared, its estates, its creditors, and all of its other stakeholders.

WHEREFORE, for the reasons set forth herein and the KEIP Motion, LightSquared respectfully requests that the Court (a) overrule the SPSO Objection, (b) enter the Order, substantially in the form attached hereto as Exhibit B, approving the Revised KEIP, and (c) grant such other and further relief as the Court may deem just and proper.

New York, New York
Dated: March 5, 2015

/s/ Matthew S. Barr
Matthew S. Barr
Steven Z. Szanzer
Karen Gartenberg
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New York, NY 10005-1413
(212) 530-5000

Counsel to Debtors and Debtors in Possession

OBJECTIVE	DESCRIPTION		
CONFIRMATION OBJECTIVE	Cash bonus of 30% of Key Employees’ annual salary (i.e., \$660,000) ¹ that would be (a) earned upon the entry of an order confirming the Plan and (b) paid upon the earlier of (i) the “Inc. Facilities Claims Purchase Date Closing Date” under the Plan and (ii) 30 days after entry of such confirmation order (provided that there is no stay of such confirmation order in effect at such time).		
CASH PRESERVATION OBJECTIVE	<ul style="list-style-type: none">Each Key Employee will earn a cash award based upon the following sliding scale:		
	Cash Bonus (% of annual salary)	April 1, 2015 – September 30, 2015 Total Operating Expenses ² (% of LightSquared’s Consolidated Budget)	Potential Net Savings to Estates
	0%	≥100%	\$0
	Lesser of 55% (approx. \$1.120 million) and 80% of actual savings	95.1-99.9% (up to approx. \$2.469 million of gross savings)	From approx. \$100.00 to approx. \$1.349 million
	57.5% (approx. \$1.265 million)	90-95% (approx. \$2.520 million to approx. \$5.040 million of gross savings)	From approx. \$1.255 million to approx. \$3.775 million
	60% (approx. \$1.320 million)	<90% (at least approx. \$5.090 million of gross savings)	At least approx. \$3.80 million
	<ul style="list-style-type: none">Based upon the measurement of LightSquared’s actual operating expense spending on September 30, 2015 or the first business day thereafter. Assumes a measurement period from April 1, 2015 to September 30, 2015. Budget figures are based on LightSquared’s current forecast for all LightSquared entities filed on February 23, 2015.		

¹ Cash bonus amounts set forth herein are aggregated for all Key Employees.

² Operating Expenses exclude all spectrum lease costs (i.e., payments under the Inmarsat Cooperation Agreement and One Dot Six lease), capital expenses, restructuring-related costs, and extraordinary legal and regulatory expenses not previously budgeted.

	<ul style="list-style-type: none"> • Calibrated such that the cash awards will get paid solely from the savings realized by LightSquared (<u>i.e.</u>, the Cash Preservation Objective is self-funding). • Once the Key Employees achieve the Cash Preservation Objective, such payment will be made within 30 days of the earlier of September 30, 2015 and the effective date of the Plan.
EFFECTIVE DATE OBJECTIVE	Cash bonus of 40% of Key Employees' annual salary (<u>i.e.</u> , \$880,000) that would be (a) earned upon the FCC's approval of a change of control, as set forth under, and pursuant to, the Plan and (b) paid within 30 days of the effective date of the Plan.

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

In re:

LIGHTSQUARED INC., *et al.*,

Debtors.¹

)
) Chapter 11
)
) Case No. 12-12080 (SCC)
)
) Jointly Administered
)

**ORDER AUTHORIZING LIGHTSQUARED TO MODIFY AND EXTEND EXISTING
KEY EMPLOYEE INCENTIVE PLAN**

Upon *LightSquared's Motion for Entry of Order Authorizing LightSquared To Modify and Extend Existing Key Employee Incentive Plan* [Docket No. 2065] (the "KEIP Motion") and the *Supplement and Reply in Support of LightSquared's Motion for Entry of Order Authorizing LightSquared To Modify and Extend Existing Key Employee Incentive Plan*, dated March 5, 2015 (the "Supplement" and, together with the KEIP Motion, the "Amended Motion")² for entry of an order (the "Order"), pursuant to sections 363 and 503 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (as amended, the "Bankruptcy Code"), authorizing LightSquared to modify and extend LightSquared's existing Key Employee Incentive Plan (the "KEIP") to accommodate the current facts and circumstances of the Chapter 11 Cases; and it appearing that this Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334; and it appearing that this proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2); and it

¹ The debtors in these Chapter 11 Cases (as defined below), along with the last four digits of each debtor's federal or foreign tax or registration identification number, are: LightSquared Inc. (8845), LightSquared Investors Holdings Inc. (0984), One Dot Four Corp. (8806), One Dot Six Corp. (8763), SkyTerra Rollup LLC (N/A), SkyTerra Rollup Sub LLC (N/A), SkyTerra Investors LLC (N/A), TMI Communications Delaware, Limited Partnership (4456), LightSquared GP Inc. (6190), LightSquared LP (3801), ATC Technologies, LLC (3432), LightSquared Corp. (1361), LightSquared Finance Co. (6962), LightSquared Network LLC (1750), LightSquared Inc. of Virginia (9725), LightSquared Subsidiary LLC (9821), Lightsquared Bermuda Ltd. (7247), SkyTerra Holdings (Canada) Inc. (0631), SkyTerra (Canada) Inc. (0629), and One Dot Six TVCC Corp. (0040). The location of the debtors' corporate headquarters is 10802 Parkridge Boulevard, Reston, VA 20191.

² Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the KEIP Motion.

appearing that venue of this proceeding and the Amended Motion in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409; and notice of the Amended Motion appearing adequate and appropriate under the circumstances; and the Court having found that no other or further notice is needed or necessary; and the Court having reviewed the Amended Motion and having heard statements in support of the Amended Motion at a hearing held before the Court (the “Hearing”); and the Court having determined that the legal and factual bases set forth in the Amended Motion and at the Hearing establish just cause for the relief granted herein; and it appearing, and the Court having found, that the relief requested in the Amended Motion is in the best interests of LightSquared’s estates, its creditors, and other parties in interest; and any objections to the relief requested in the Amended Motion having been withdrawn or overruled on the merits; and after due deliberation and sufficient cause appearing therefor, it is hereby

ORDERED that:

1. The Amended Motion is granted as provided herein, and the modifications and extensions to LightSquared’s existing Key Employee Incentive Plan (approved on October 23, 2012), as summarized in the Amended Motion, are approved in their entirety.
2. Pursuant to sections 363(b) and 503(c) of the Bankruptcy Code, LightSquared is authorized to take all actions necessary to implement the modifications to its existing Key Employee Incentive Plan, as summarized in the Amended Motion, and to make the payments contemplated thereunder.
3. LightSquared is authorized and empowered to take all other actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Amended Motion.
4. Notwithstanding the possible applicability of Bankruptcy Rule 6004(h) or

otherwise, the terms and conditions of this Order shall be effective and enforceable immediately

5. The requirements set forth in Local Rule 9013-1(a) are satisfied.

6. The Court retains jurisdiction with respect to all matters arising from or

Dated: _____, 2015

HONORABLE SHELLEY C. CHAPMAN

EXHIBIT D

EXHIBIT D

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

In re:)	
)	Chapter 11
)	
LIGHTSQUARED INC., <i>et al.</i> ,)	Case No. 12-12080 (SCC)
)	
Debtors. ¹)	Jointly Administered
)	

**ORDER AUTHORIZING LIGHTSQUARED TO MODIFY AND EXTEND EXISTING
KEY EMPLOYEE INCENTIVE PLAN**

Upon *LightSquared's Motion for Entry of Order Authorizing LightSquared To Modify and Extend Existing Key Employee Incentive Plan* [Docket No. 2065] (the "KEIP Motion") and the *Supplement and Reply in Support of LightSquared's Motion for Entry of Order Authorizing LightSquared To Modify and Extend Existing Key Employee Incentive Plan*, dated March 5, 2015 (the "Supplement" and, together with the KEIP Motion, the "Amended Motion")² for entry of an order (the "Order"), pursuant to sections 363 and 503 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (as amended, the "Bankruptcy Code"), authorizing LightSquared to modify and extend LightSquared's existing Key Employee Incentive Plan (the "KEIP") to accommodate the current facts and circumstances of the Chapter 11 Cases; and it appearing that this Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334; and it appearing that this proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2); and it

¹ The debtors in these Chapter 11 Cases (as defined below), along with the last four digits of each debtor's federal or foreign tax or registration identification number, are: LightSquared Inc. (8845), LightSquared Investors Holdings Inc. (0984), One Dot Four Corp. (8806), One Dot Six Corp. (8763), SkyTerra Rollup LLC (N/A), SkyTerra Rollup Sub LLC (N/A), SkyTerra Investors LLC (N/A), TMI Communications Delaware, Limited Partnership (4456), LightSquared GP Inc. (6190), LightSquared LP (3801), ATC Technologies, LLC (3432), LightSquared Corp. (1361), LightSquared Finance Co. (6962), LightSquared Network LLC (1750), LightSquared Inc. of Virginia (9725), LightSquared Subsidiary LLC (9821), Lightsquared Bermuda Ltd. (7247), SkyTerra Holdings (Canada) Inc. (0631), SkyTerra (Canada) Inc. (0629), and One Dot Six TVCC Corp. (0040). The location of the debtors' corporate headquarters is 10802 Parkridge Boulevard, Reston, VA 20191.

² Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the KEIP Motion.

appearing that venue of this proceeding and the Amended Motion in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409; and notice of the Amended Motion appearing adequate and appropriate under the circumstances; and the Court having found that no other or further notice is needed or necessary; and the Court having reviewed the Amended Motion and having heard statements in support of the Amended Motion at a hearing held before the Court (the “Hearing”); and the Court having determined that the legal and factual bases set forth in the Amended Motion and at the Hearing establish just cause for the relief granted herein; and it appearing, and the Court having found, that the relief requested in the Amended Motion is in the best interests of LightSquared’s estates, its creditors, and other parties in interest; and any objections to the relief requested in the Amended Motion having been withdrawn or overruled on the merits; and after due deliberation and sufficient cause appearing therefor, it is hereby

ORDERED that:

1. The Amended Motion is granted as provided herein, and the modifications and extensions to LightSquared’s existing Key Employee Incentive Plan (approved on October 23, 2012), as summarized in the Amended Motion, are approved in their entirety.
2. Pursuant to sections 363(b) and 503(c) of the Bankruptcy Code, LightSquared is authorized to take all actions necessary to implement the modifications to its existing Key Employee Incentive Plan, as summarized in the Amended Motion, and to make the payments contemplated thereunder.
3. LightSquared is authorized and empowered to take all other actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Amended Motion.
4. Notwithstanding the possible applicability of Bankruptcy Rule 6004(h) or

otherwise, the terms and conditions of this Order shall be effective and enforceable immediately upon its entry.

5. The requirements set forth in Local Rule 9013-1(a) are satisfied.

6. The Court retains jurisdiction with respect to all matters arising from or related to the implementation and interpretation of this Order.

Dated: March 27, 2015
New York, New York

/S/ Shelley C. Chapman
HONORABLE SHELLEY C. CHAPMAN
UNITED STATES BANKRUPTCY JUDGE