UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

In re: Alpha Natural Resources, Inc., *et al.*, Debtors.	Chapter 11 Case No. 15-33896-KRH (Jointly Administered)

THE UNITED STATES TRUSTEE'S COMBINED OPPOSITION TO DEBTORS' MOTIONS: (1) FOR APPROVAL OF KEY EMPLOYEE INCENTIVE PLAN, AND (2) TO SEAL APPENDIX 2 TO DECLARATION OF ROBERT ROMANCHEK

The United States Trustee for Region Four, which includes the Eastern District of Virginia, Richmond Division, pursuant to §§ 107 and 503 of the Bankruptcy Code and Rules 9013 of the Federal Rules of Bankruptcy Procedure and Rule 9013-1(H) of the Local Rules for this District, files this opposition to the following two related motions filed as documents 1038 and 1039 respectively:

1. *"Motion of the Debtors for Entry of an Order (I) Authorizing Payments Under 2015 Annual Incentive Bonus Plan and (II) Approving Key Employee Incentive Plan For Certain Insider Employees for 2016"* (the "**KEIP Motion**").

2. *"Motion of the Debtors, Pursuant to Sections 107(b)(1) and 107(c)(1) of the Bankruptcy Code and Bankruptcy rule 9018, to File Under Seal Appendix 2 to Declaration of Robert Romanchek in Support of Motion of the Debtors for Entry of an Order (I) Authorizing Payments Under 2015 Annual Incentive Bonus Plan and (II) Approving Key Employee Incentive Plan For Certain Insider Employees for 2016."* (the "**Sealing Motion**").

INTRODUCTION

Alpha Natural Resources, Inc. and 150 of its affiliated entities (collectively "Alpha")

Robert B. Van Arsdale, AUST (Va. Bar No. 17483)
Shannon Pecoraro, Esq. (Va. Bar No. 46864)
Office of the United States Trustee
701 East Broad Street - Suite 4304
Richmond, VA 23219
Telephone (804) 771-2310
Facsimile (804) 771-2330

filed the KEIP Motion requesting, *inter alia*, authority to pay 15 of its most highly compensated executives bonuses totaling over $11.9 Million in 2016. Alpha seeks this relief while at the same time incurring more than $1.3 Billion in losses for 2015. Alpha seeks this relief while at the same time seeking to cut off the health and life insurance benefits to some 1,200 rank-and-file retirees because it claims it desperately needs to save $3 Million a year. Alpha seeks this relief after demonstrating to this Court that it is so hopelessly insolvent that its shareholders have no chance of seeing any return on their investments into the companies.

According to Alpha, these executives need these bonuses as an incentive to do the very jobs they were hired to do, that they are already highly compensated for with generous salaries, and which their fiduciary duties already compel them to do. Such bonuses cannot be justified under the facts and circumstances of this case.

Moreover, the proposed bonuses do not comply with Section 503(c) of the Code. The bonus plan is not a true incentive program. Rather, it is a disguised retention program that is prohibited in bankruptcy cases absent extremely specific and unusual circumstances that do not exist here. The so-called "performance metrics" that Alpha must meet in order for these executives to "earn" the bonuses are basically a *fait accompli*. Indeed, the metric comprising 55% of the entitlement to the bonuses has been met and exceeded nearly every month since this case was filed.

In addition to paying these bonuses, Alpha asks this Court's permission to conceal the identity of executives taking these payments, the amount of the bonuses Alpha intends to pay each of these executives, and the compensation these executives are already receiving. In other words, Alpha seeks to conceal all of the information parties in interest would need to evaluate the propriety of the bonuses.

Disclosure is the cornerstone of bankruptcy relief. Alpha voluntarily sought the extraordinary relief and protection available under the Bankruptcy Code. The cost of that relief is full disclosure of its operations. If Alpha desires to pay secret bonuses to a confidential group of its top executives, it can certainly do so – just not while enjoying the protection and benefits of the Bankruptcy Code.

For the reasons stated above, and described more fully below, the Court should deny the KEIP Motion and the Sealing Motion.

FACTS AND BACKGROUND

A. Alpha's Financial Condition

1. Since peaking around 2011, Alpha has shown a steady decline in profitability.

2. As of June 2011, Alpha was generating approximately $7 Billion in annual gross revenues. (*See* Am. Crutchfield Decl., Doc. 45 at ¶ 9.) By 2014, however, Alpha's gross revenues were down to $4.3 Billion. *Id.* at ¶ 16. By August of 2015, Alpha was suffering, in the words of its CEO, "substantial negative cash flow." *Id.* at ¶ 29.

3. Since 2011, Alpha has idled or closed more than 80 mines, adversely impacting the livelihood of approximately 7,000 employees and their families. *Id.* at ¶ 26.

4. Indeed, since filing this bankruptcy case, Alpha has continued to suffer substantial losses. In October, Alpha's operations lost nearly $65 Million and in November over $70 Million. (*See* Oct. Monthly Operating Report, doc. 979 at 15 of 21; Nov. Monthly Operating Report, doc. 1146, at 15 of 21.) As of November 30, 2015, Alpha's year-to-date losses exceeded $1.3 Billion. (Nov. Monthly Operating Report, doc. 1146, at 15 of 21.)

5. As a result of this financial deterioration, Alpha sought relief under Chapter 11 of the Bankruptcy Code. (*See* Doc. 1.) Alpha has expressly conceded that the filing of the

bankruptcy imputed its management with a fiduciary duty to maximize the value of its operations. (*See* Debtor's Objection to Motion for Appointment of Equity Committee, doc. 1062, at ¶ 14.)

6. Alpha has recently described itself as "hopelessly insolvent." *Id.* at ¶ 4.

7. In an effort to save $3 Million this year, Alpha filed a motion to terminate the health and life insurance benefits of approximately 1,200 non-union retirees. (*See* Mot. to Terminate Certain Unvested Non-Pension Benefits, doc. 797 at ¶ 8.)

8. Against this backdrop, Alpha seeks to pay bonuses totaling over $11.9 Million to 15 of its most highly compensated executives (the "Executives"). (*See generally,* KEIP Mot.)

B. <u>Events Since The Filing Of The KEIP Motion.</u>

9. On December 3, 2015, Debtors filed the KEIP Motion. (*See* Doc. 1038.) The KEIP Motion initially sought to permission to pay 17 Executives bonuses of up to $14.8 Million as part of a "Key Employee Incentive Plan" ("KEIP"). (*See* KEIP Mot. at ¶ 24.)

10. Since then, various objecting and potentially objecting parties have engaged in discovery and negotiations with Alpha over the KEIP. As a result of negotiations between Alpha and the Creditors Committee (and perhaps others as well), certain provisions of the KEIP have been revised, including a reduction in the maximum amount of the bonus payments and the timing of the payments.

11. In addition, two of the Executives have terminated their employment with Alpha. As a result, the number of Executives participating in the proposed KEIP has been reduced to 15.

C. <u>The Sealing Motion.</u>

12. Along with the KEIP Motion, Alpha filed the Sealing Motion. By the Sealing Motion, Alpha seeks to keep secret the identity of the Executives, their compensation, and the

proposed bonus Alpha seeks to pay them under the KEIP.

D. The KEIP.

13. Historically, the Executives received three principal forms of compensation: (a) base salary; (b) cash bonuses; and (c) "equity incentive awards." (Mot. at ¶ 13.)[1]

14. Prior to filing bankruptcy, the "cash bonus" portion of the Executives' compensation package was provided in the form of an "Annual Incentive Bonus" plan (the "AIB").[2] (*See* KEIP Mot. at ¶¶ 15-17.)

15. For 2016, Alpha proposes to replace the AIB portion of the Executives' compensation with the KEIP. *Id.*

16. As the AIB historically did, the KEIP provides the Executives a bonus if Alpha meets certain goals or "metrics." (*See* KEIP Mot. at ¶¶ 15, 20-22.)

17. The details of the performance metrics, and how each factors into the amount of the bonuses under the KEIP, will be discussed *infra*. First, however, it is important to understand how the Executives are compensated if the performance metrics are met.

E. The KEIP Goal Levels.

18. As the AIB historically did, the KEIP sets three different goal levels for each performance metric: a "threshold" goal, a "target" goal, and a "maximum" goal. (*See* KEIP Mot. at 21.)

19. In order for the Executives to receive a bonus under the KEIP, Alpha must meet the "threshold" goal of one of the performance metrics. (*See* Romanchek Aff., doc. 1038 at Ex.

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[1] While Alpha describes these three forms of compensation as the Executives' "principal" forms of compensation, it concedes the Executives receive other compensation as well. (*See* KEIP Mot. at 8, n.3.)

[2] The KEIP Motion also seeks permission to make post-petition payments under the 2015 AIB entered into pre-petition. The United States Trustee takes no position with respect to that request.

C., ¶ 11.) If Alpha meets the "threshold" goal of a performance metric, the Executives receive a bonus associated with that metric. If Alpha meets the "target" goal for that metric, the Executives receive a larger bonus, and if Alpha meets the "maximum" goal, the Executives receive an even larger bonus. *Id.*

20. The amount of any Executive's bonus under the KEIP is a factor of the particular Executive's base salary and the goal level that is met. The amount of any Executive's bonus if Alpha meets all of the "target" level performance metrics is a percentage of the Executive's salary. *Id.* Under the KEIP, the various Executives' bonus where Alpha meets all of the "target" performance metrics range from 60% of base salary for some Executives to as much as 175% of base salary for others. *Id.* at Appx. 2 (filed under seal).

21. If Alpha meets only the "threshold" performance level, the bonus paid is 50% of the bonus that would be paid for meeting the "target" level. *Id.* at ¶¶ 14, 20. If Alpha meets the "maximum" performance level, the bonus is 175% of the "target" level bonus.[3] *Id.*

22. If Alpha meets all of the performance metrics at the "threshold" level, the Executives will be paid bonuses totaling approximately $3.4 Million. If Alpha meets the performance metrics at the "target" level, the bonuses will total approximately $6.8 Million. And, if Alpha meets the performance metrics at "maximum" level, the Executives will be paid a total of just over $11.9 Million. *Id.* at ¶ 14.[4]

23. The potential payouts under the KEIP on an individual level range from just over

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[3] Historically under the AIB, and in the originally proposed KEIP, the payout for meeting the "maximum" performance metric was 200% of the "target" level payout. This was reduced to 175% as a result of negotiations between Alpha and the Creditors Committee.

[4] Originally, the total proposed bonuses for meeting the various performance levels were higher. For example, the total bonus amount for "maximum" level was approximately $14.8 Million and for "target" level was approximately $7.4 Million. (KEIP Mot. at ¶ 24.) The reductions are due to the departure of two Executives from Alpha and the negotiated reduction of the "maximum" bonus from 200% of the "target" bonus to 175% of the "target" bonus.

$80,000 per Executive to more than $3.2 Million per Executive. *Id.* at Appx. 2 (filed under seal).

24. The KEIP bonuses are considerably higher than they had been historically under Alpha's AIBs. While bonuses under the AIB in 2013, 2014 and 2015 for meeting the "target" performance metric ranged from 40% of base salary to 120% of base salary depending upon the Executive, under the KEIP that range has increased to 60% to 175% of the various Executives' base salaries. *Id.*

25. The total bonuses proposed at "target" level under the KEIP are $6.8 Million. By comparison, in 2015 the bonuses at "target" level for these 15 Executives or their equivalents totaled only $4.2 Million. In 2014 that total was only $3.7 Million and in 2013, $3.4 Million. The following chart compares total payouts proposed under the KEIP with the AIBs for 2013, 2014 and 2015:

	Threshold	Target	Maximum
KEIP	$3,407,975.00	$6,815,950.00	$11,927,913.00
2015 AIB	$2,109,975.00	$4,219,950.00	$8,439,900.00
2014 AIB	$1,879,852.00	$3,759,704.00	$7,519,408.00
2013 AIB	$1,711,102.00	$3,422,204.00	$6,844,408.00

F. <u>The Performance Metrics.</u>

26. Historically, the AIBs had performance metrics relating to the following areas:

a. Profitability
b. Expense Reduction
c. Liquidity
d. Gross Debt Reduction
e. Safety
f. Environmental.

(KEIP Mot. at ¶ 15.)

27. Each metric was worth a percentage of the total bonus. Thus, for example, if a particular performance metric was worth 10%, then by meeting the "target" level for that metric, the Executives would earn 10% of their "target" level bonus. *Id.*

28. Not surprisingly, the most significant metric under the AIBs was the "Profitability" metric. Under the AIBs, causing Alpha to achieve certain levels of profitability was worth 40% of the total bonus available under the AIBs. *Id.* at ¶ 15(a).

29. Although renamed and somewhat reconfigured, the KEIP utilizes the same performance metrics with one significant exception: *there is no profitability metric*. (KEIP Mot. at ¶¶ 26-29.)

30. The KEIP omits the performance metric that constituted 40% of the AIB. Thus, under the KEIP, the Executives can earn the full amount of their bonuses even if they fail to cause Alpha to earn any money or even if Alpha continues its pattern of showing losses month after month.

31. The KEIP contains 4 performance metrics:

a. Cost Savings[5]
b. Liquidity
c. Safety
d. Environmental.

(*See* KEIP Mot at ¶¶ 26-29.)

Cost Savings Metric

32. The "Cost Savings" metric is essentially a renamed iteration of the AIB's "Expense Reduction" metric. (*Compare* KEIP Mot. at ¶ 26 with ¶15(b).) To meet the goals of

[5] This performance metric was designated the "Value Enhancement Plan" in the KEIP as originally proposed. (KEIP Mot. at ¶ 26.) It was subsequently renamed the "Cost Savings" metric, presumably to more accurately describe the nature of the metric.

this metric, Alpha must achieve specified levels of "cost savings" as a result of "executed initiatives."[6] The savings necessary to achieve this metric are as follows:

- Threshold: $64 Million
- Target: $75 Million
- Maximum: $82 Million.

33. The "Cost Savings" metric is worth 30% of the total bonus award under the KEIP. (KEIP Mot. at ¶¶26, 30.)

34. The baseline against which these savings are measured is not disclosed.

Liquidity

35. The "Liquidity" metric is satisfied if Alpha has specified amounts of "adjusted ending book cash" on June 30, 2016. (*See* Romanchek Aff., doc. 1038 at 57, ¶ 17.)

36. The "adjusted ending book cash" Alpha must have on June 30, 2016, for each of the bonus levels are the following:

- Threshold: $675 Million
- Target: $775 Million
- Maximum: $825 Million[7]

37. Although it was only worth 10% of the total bonus available under the AIB, the "Liquidity" metric is worth 55% of the total bonus award under the KEIP. (*Compare* Mot. at ¶ 15(c), to Romanchek Aff. at ¶¶ 17, 20.)

38. At the end of both September 2015 and October 2015, Alpha had sufficient cash to meet the "Maximum" level goal. (*See* September Monthly Operating Report, doc. 979 at 14 of 21; October Monthly Operating Report, doc. 726 at 14 of 21). At the end of November, 2015,

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[6] None of these "initiatives" are described in the Motion.

[7] This was originally $800 Million. (*See* KEIP Mot at ¶ 30.) The amount was increased as a result of the negotiations between Alpha and the Creditors Committee.

that amount had dropped somewhat, but was still sufficient to meet the "Threshold" level goal. (Nov. Monthly Operating Report, doc. 1146 at 14 of 21.)

Safety

39. The "Safety" metric is satisfied if Alpha loses less than a specified number of "non-fatal" days before June 30, 2016. (Romanchek Aff. at ¶ 18.)

40. The non-fatal days lost for each goal level must be less than the following:

- Threshold: 2.78 days
- Target: 2.42 days
- Maximum: 2.18 days.

41. The "Safety" metric is worth 7.5% of the total bonus under the KEIP. (Romanchek Aff. at ¶ 19.)

Environmental

42. The "Environmental" metric is satisfied if the ratio of "Water Quality Exceedances" to "NPDES Outlets" is less than the following:

- Threshold: 23
- Target: 20
- Maximum: 18.[8]

43. The "Environmental" metric is worth 7.5% of the total bonus awards under the KEIP. (KEIP Mot. at ¶¶ 29, 30.)

ARGUMENT

[8] This ratio, referred to by Alpha as the "EC Ratio" is described in more detail in the Declaration of Robert Romanchek at ¶18.

A. <u>The Sealing Motion should be denied.</u>

Bankruptcy Rule 5001(b) provides, in pertinent part, as follows: "All trials and hearings shall be conducted in open court and so far as convenient in a regular court room." *See In re Global Crossing Ltd.*, 295 B.R. 720, 723-24 (Bankr. S.D.N.Y. 2003); *see also Brown v. Williamson Tobacco Corp. v. Federal Trade Comm'n*, 710 F.2d 1165, 1178 (6th Cir. 1983) (holding that the "open courtroom has been a fundamental feature of the American judicial system"). Thus, parties seeking to deny public access to court documents must overcome a strong presumption. *Neal v. The Kansas City Star* (*In re Neal*), 461 F.3d 1048, 1053 (8th Cir. 2006); *Gitto v. Worcester Telegram & Gazette Corp.* (*In re Gitto Global Corp.*), 422 F.3d 1, 6 (1st Cir. 2005).

In the bankruptcy context, the general rule of open access is set forth in Section 107(a) of the Bankruptcy Code, which provides that, subject to certain limited exceptions, "a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by an entity at reasonable times without charge." 11 U.S.C. § 107(a). *See In re Food Management Group, LLC,* 359 B.R. 543, 553-555 (Bankr. S.D.N.Y. 2007) (section 107 reflects Congress's intent to favor public access to papers filed with the bankruptcy court).

Section 107 of Title 11 reflects the strong public policy in favor of papers filed in the bankruptcy courts remaining open and available to the public for review:

> (a) Except as provided in subsections (b) and (c) of this section and subject to section 112,[9] a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by an entity at reasonable times without charge.

11 U.S.C. §107(a). The court may protect documents in only three circumstances. The

[9] 11 U.S.C. § 112 is a prohibition on the disclosure of the names of minor children, and is not relevant here.

exceptions in subsection (b) permit the court to protect entities "with respect to a trade secret or confidential research, development, or commercial information" and to "protect a person with respect to scandalous or defamatory matter contained in a paper filed" in a bankruptcy case. 11 U.S.C. § 107(b). The exception in subsection (c) permits the court to prevent disclosure of "means of identification" or similar information that "would create undue risk of identity theft or other unlawful injury to the individual or the individual's property. 11 U.S.C. § 107(c). Fed. R. Bankr. P. 9018 governs proceedings to seal documents.

Although there is no Fourth Circuit law on Section 107, four courts of appeals have considered the statute. They agree that Section 107 abrogates the common law rule giving courts general discretion to create exceptions to the right of public access for "compelling reasons." *See Father M v. Various Tort Claimants (In re Roman Catholic Archbishop of Portland)*, 661 F.3d 417, 430-31 (9th Cir. 2011); *Neal, supra*; *Gitto, supra; In re Orion Pictures Corp.*, 21 F.3d 24, 26 (2d Cir. 1994). Accordingly, the plain text of Section 107 "limits the discretion of courts regarding public access to papers filed in a bankruptcy case ... unless material contained therein falls within one of the statutory exceptions." *Gitto*, 422 F.3d at 11.

As such, a "court's ability to limit the public's right to access remains an extraordinary measure that is warranted only under rare circumstances as public monitoring is an essential feature of democratic control." *Togut v. Deutsche Bank AG (In re Anthracite Capital, Inc.),* 492 B.R. 162, 171 (Bankr. S.D.N.Y. 2013) (internal quotation omitted); *see Gitto*, 422 F.3d at 11 (requiring "something more" than potential "detrimental impact on an interested party's reputation"). In evaluating a motion to seal, courts must "carefully and skeptically review" the motion and underlying documents to ensure that "compelling or extraordinary circumstances exist." *Orion Pictures*, 21 F.3d at 27; *see, e.g.*, *In re Nunn*, 49 B.R. 963, 964 (Bankr. E.D.Va.

1985) (sealing documents should "be the exception rather than the rule"); *In re Epic Associates V,* 54 B.R. 445, 448 (Bankr. E.D.Va. 1985) ("[i]t is a highly unusual and extraordinary remedy for the Court to seal the records in any case").

The Debtors argue that Appendix 2 to Mr. Romanchek's Affidavit contains confidential commercial information regarding the Executives' "identity, title and compensation." (Sealing Mot. at ¶ 12.) In addition, the Debtors argue that the exhibits contain "means of identification" of the Executives that should be protected pursuant to 11 U.S.C. §107(c)(1)(A). (Sealing Mot. at ¶ 13.)

1. The Sealing Motion fails to allege any "confidential commercial information" that would trigger the statutory exception to public disclosure.

"Commercial information" under section 107(b)(1) is "information which would cause an unfair advantage to competitors by providing them information as to the commercial operations of the debtor." *Orion*, 21 F.3d at 27 (citations omitted). Information protected under this exception has typically included information that would result in a "direct and adverse" impact on a party, such as (a) the terms of a licensing agreement that would have impaired a party's ability to conduct contract negotiations; (b) a copy of a confidential customer list that the debtor previously sold to a creditor; and (c) documents that detailed a hedge fund's investment strategy. *Id.*; *In re A.G. Fin. Serv. Ctr.*, 395 F.3d 410, 415-16 (7th Cir. 2005); *In re Dreier LLP*, 485 B.R. 821, 823 (Bankr. S.D.N.Y. 2013). In contrast, courts have not protected information such as settlement agreements and general information about organizational structure. *Dreier*, 485 B.R. at 823; *In re Oldco M Corp.*, 466 B.R. 234, 238 (Bankr. S.D.N.Y. 2012).[10]

[10] Recently, the United States District Court for the Eastern District of Virginia affirmed this Court's decision to seal a report regarding the internal conduct of an attorney's law practice. *See Robbins v. Tripp (In re: Mack)*, 510

In the instant case, Alpha seeks to conceal information essential to determination of the KEIP Motion. Specifically, Alpha does not wish to disclose the Executives' names, titles, amounts these employees are to receive, or the amount of other compensation they receive. Alpha also proposes to seal the relevant information to calculate the thresholds to determine the amount of bonuses that each Executive can receive. Without such information, parties in interest will be deprived of the opportunity to ascertain whether the payments are reasonable or warranted under the circumstances of these Chapter 11 cases.

Alpha has failed to show that the Executives' names and their proposed bonuses constitute "a trade secret or other confidential research, development, or commercial information," nor have they alleged a direct and adverse impact that any disclosure would cause.

2. The Sealing Motion does not allege any undue risk of identity theft or unlawful injury to the KERP and KEIP Participants sufficient to warrant the sealing of their identities and compensation amounts.

Section 107(c) permits the bankruptcy court to "protect an individual" from the disclosure of "means of identification" that, if disclosed, would "create undue risk of identity theft or other unlawful injury to the individual or the individual's property." 11 U.S.C. § 107(c). The only "means of identification" under 18 U.S.C. § 1028(d) included in the exhibits filed under seal are the Executives' names. The United States Trustee agrees that the names of employees are "means of identification" as that term is used in Section 107; however, there is no allegation that the disclosure of employees' names subjects them or their property to an "undue

(continued …)

B.R. 61 (E.D.Va. April 28, 2014). The unique facts and procedural context in which the *Tripp* matter arose distinguish it from the information sought to be sealed here.

risk of identity theft or other unlawful injury" as required by the statute. Accordingly, the exhibit should be unsealed.

B. <u>The KEIP Should Be Disallowed.</u>

1. <u>The KEIP is a Disguised KERP.</u>

The Bankruptcy Code classifies expenses of the bankruptcy estate as "administrative expenses," which are paid in full before any distribution is made to unsecured creditors. *See* 11 U.S.C. §§ 503(b), 507. Section 503(b) provides, in relevant part, that "there shall be allowed administrative expenses ... including ... (1)(a)(i) wages, salaries and commissions for services rendered after the commencement of the case…."

Section 503(c) was enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") to respond to "glaring abuses of the bankruptcy system by the executives of giant companies like Enron Corp, and WorldCom Inc. and Polaroid Corporation, who lined their own pockets but left thousands of employees and retirees out in the cold." (Floor Statement, quoted in *In re Dana Corp.,* 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006)). The abuses at which the provision is aimed regularly manifest themselves in the guise of insider retention plans, often referred to as Key Employee Retention Plans ("KERP"). *See* 3 COLLIER ON BANKRUPTCY ¶ 503.17[1] at 503-105 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013) (section 503(c)'s "purpose was to limit the scope of … programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor").

As this Court has previously explained:

> All too often [insider retention plans] have been used to lavishly reward -- at the expense of the creditor body -- the very executives whose bad decisions or lack of foresight were responsible for the

> debtor's financial plight. But even where external circumstances rather than the executives are to blame, there is something inherently unseemly in the effort to insulate executives from the financial risks all other stakeholders face in the bankruptcy process.

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

KERPs are governed by 11 U.S.C. § 503(c)(1), which precludes the paying of bonuses "for the purpose of inducing such person to remain with the debtors' business" unless the strict conditions set out in subsections 503(c)(1)(A), (B), and (C) are met. 11 U.S.C. § 503(c)(1). These conditions require: (1) the insider have a bona fide job offer elsewhere, (2) the insider's services must be "essential" to the debtor, and (3) the payment must be under certain monetary limits. *Id*.

Accordingly, a bankruptcy court must determine whether a proposed insider payment plan was made "for the purpose" of inducing the insider to remain with the debtor. *Id*. Simply labelling a bonus payment plan as an "incentive" plan or KEIP is insufficient to avoid court inquiry into whether the plan is prohibited under section 503(c)(1). *In re Velo Holdings Inc.*, 472 B.R. 201, 209 (Bankr. S.D.N.Y. 2012).[11]

"Incentive" is defined as "something that incites or has a tendency to incite to determination or action." *Velo Holdings*, 472 B.R.at 211 (citing WEBSTER'S NINTH NEW

[11] Careful judicial review of proposed incentive plans for disguised retention plans is consistent with the clear congressional mandate to prevent insolvent companies from rewarding its insiders with retention bonuses. *See Grassley Probes DOJ for Policies on KERPs*, 31-2 AM. BANKR. INST. J. 8 (March 2012) (in response to *Wall Street Journal* report that companies in chapter 11 continue to pay bonuses to top executives in form of "incentive" plans, Senator Grassley, chief Senate sponsor of the Reform Act, looks into whether companies are "masking retention plans under the guise of incentive plans, in conflict with Congressional intent").

COLLEGIATE DICTIONARY 608 (9th ed. 1984)). Thus, an "incentive" bonus is one that would incite an employee to work harder or achieve a particular goal. Accordingly, in reviewing proposed insider incentive bonus plans, courts consider the difficulty of achieving the proposed target goals. *See, e.g, In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 313 (S.D.N.Y. 2012) (court must determine whether proposed targets "are designed to motivate insiders to rise to a challenge or merely report to work"). Where targets of incentive plans have been deemed to be too easily attainable, such plans have been held to be retention plans in disguise. *See id.* at 313-15 (denying KEIP as disguised retention plan where lowest incentivizing levels were "well within reach").

Moreover, nothing in the statute limits the bankruptcy court's review to just the objective features of the proposed plan. The bankruptcy court has discretion to view other evidence, including testimony of debtor's witnesses, to determine whether a debtor proposed a bonus payment plan for the purpose of inducing its insiders to remain with the debtor. *See Hawker Beechcraft,* 479 B.R at 314. In *Hawker Beechcraft*, the debtor's chief executive officer had testified that without the proposed incentive plan, his senior management "could seek alternative employment opportunities" which would undermine their attempt to restructure under chapter 11. *Id.* The court found that this testimony "confirmed the retentive purpose" of the proposed incentive plan. *Id.*

The proponent of a purported "incentive" plan bears the burden of proving that the proposed plan is not a retention plan governed by section 503(c)(1). *Hawker Beechcraft,* 479 B.R at 313. If Alpha fails to meet that burden, and the conditions under section 503(c)(1) are not met, the KEIP cannot be approved.

Here, the evidence will show that the performance metrics are insufficiently meaningful

to constitute a true KEIP and that the KEIP is really a disguised KERP governed by 11 U.S.C. Section 503(c)(1). For example, there is no metric that even requires Alpha to make money or be profitable - the primary function of any for-profit business. Profitability was the single largest component of the AIB. Now, it is a non-factor.

Instead, 55% of the bonus is based on nothing more than how much money Alpha has in the bank on June 30, 2016. That "metric" is so easily met that Alpha has managed to do it most of the time it has been in bankruptcy, even while generating over $100 Million in losses during the same period. Moreover, that metric is easily manipulated, for example, by withholding payments from creditors, taking short-term loans, or cashing out securities.

Alpha was well aware that the "liquidity" metric is meaningless. It was worth only 10% of the bonuses historically provided under the AIB.

In addition, Alpha itself has noted that the real reason it desires this "incentive" plan is in substantial part because of fears its high level executives will leave Alpha for greener pastures. In the Declaration of Patrick Hassey in support of the KEIP's approval, Mr. Hassey explains that, for certain members of Alpha's senior management, the pressures of maintaining and preserving Alpha's business "have proven too much, and they have left the Debtors." (Hassey Decl., Doc. 1038 at 42, ¶ 7,)

Because the KEIP is really a disguised KERP, it cannot be approved unless each of the Executives meets the strict requirements of Section 503(c)(1). Alpha does not even allege that it meets those criteria.

2. The KEIP Bonuses Are Not Justified by the Facts and Circumstances of This Case.

Even if the KEIP is not a disguised KERP, the Court must also consider whether the payments are permissible under Section 503(c)(3). *In re Dana Corp.*, 358 B.R. 567, 576 (Bankr.

S.D.N.Y. 2006). The plain meaning of the statutory language of section 503(c)(3) is clear. "[W]hen the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms." *See Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). Section 503(c) mandates that "there shall neither be allowed, nor paid," transfers or obligations that are (1) "outside the ordinary course of business" and (2) "not justified by the facts and circumstances of the case." 11 U.S.C. § 503(c)(3). The statutory text squarely places a duty on the bankruptcy court to determine whether a proposed transfer constituting an administrative expense is justified by the case's facts and circumstances.

The text of section 503(c)(3) places a fact-finding duty upon the bankruptcy court to determine whether a payment outside the ordinary course of business was justified. Prior to 2005, executive bonuses that were outside the ordinary course of business were approved pursuant to the more permissive standard of section 363(b). *See, e.g., Montgomery Ward Holding Corp.*, 242 B.R. at 152-53. The statutory language of section 363(b) provides in relevant part: "The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate…." 11 U.S.C. § 363(b)(1) (emphasis added).

In adopting section 503(c), Congress expressly moved away from the general permissive standard of section 363(b) towards a more specific statutory prohibition of bonus payments absent factual findings of justification by the bankruptcy court. 11 U.S.C. §503(c)(3). The Supreme Court has held that it is a "well established canon of statutory interpretation" that "the specific governs the general." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2070-2071 (2012) (citations omitted). This canon may be applied to statutes where "a general authorization and a more limited, specific authorization exist side-by-side." *Id*. This

canon of statutory interpretation avoids "the superfluity of a specific provision that is swallowed by the general one, violating the cardinal rule that, if possible, effect shall be given to every clause and part of a statute." *Id.* (citations omitted).

To continue to apply the section 363(b) standard to "outside the ordinary course" bonus payment plans after Congress adopted the BAPCPA would improperly render section 503(c) meaningless. *Pilgrim's Pride Corp.*, 401 B.R.at 236-37. "Congress is presumed to intend that independent sections of the Code will have independent, differing impacts." *Id.* (citing *BFP v. Resolution Trust, Corp.*, 511 U.S. 531, 537 (1994)). "To read section 503(c)(3) as requiring nothing not already required by section 363(b)(1) would violate this principle of construction." *Id.*; 4 COLLIER ON BANKRUPTCY ¶ 503.17[4] at 503-112 (finding persuasive the *Pilgrim's Pride* court's "sound reasons" for imposing a stricter standard under section 503(c)(3) than section 363(b)(1)).

Thus, it is clear that Section 503(c) is "intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it." *Pilgrims' Pride*, 401 B.R. at 237. The evidence will also show the bonuses provided by the KEIP cannot be justified by the facts and circumstances of this case as required by Section 503(c)(3).

Alpha is in such dire financial straits that it has generated over $1.3 Billion in losses in the first 11 months of 2015. It has represented to its shareholders that it is so hopelessly insolvent they have no chance of recovering anything on their investment. Alpha was so desperate to save $3 Million that it has requested permission to cut off the health insurance benefits promised to its rank-and-file retired employees, many of whom may well be suffering devastating illnesses and conditions as a result of the very service they gave to Alpha.

Yet, Alpha wants to give its 15 most highly compensated employees an additional $11.9 Million to perform the very tasks they are employed to perform and that their fiduciary duties require. The facts and circumstances of this case do not justify the payment of such exorbitant bonuses to its already highly compensated Executives.

Moreover, even if the Executives cannot or will not perform their job duties without millions of dollars in bonuses, the Executives are no longer carrying this weight alone. Alpha has retained – and promised to pay – numerous financial and legal professionals to render advice concerning how Alpha’s businesses should be run, how to turn the business around and reorganize, and how to achieve the very goals of the KEIP’s performance metrics. Even assuming meeting the performance metrics are legitimate and important functions of the Executives, there is no evidence that the Executives will not do their best to meet these metrics absent the KEIP bonuses. Moreover, even if the Executives will not perform in exchange for their already generous salaries, Alpha is already paying millions to specialized professionals to assist with these functions.

The KEIP Motion fails to set forth any basis to determine that it is the Executives' efforts rather than the efforts of the highly compensated financial professionals that warrants bonuses for the former. Given that these professionals stand to be paid handsomely for their services, it is unclear what additional value the proposed bonuses will provide.

CONCLUSION

For the reasons stated above, the Court should deny the KEIP Motion and the Sealing Motion.

Respectfully Submitted,

Dated: January 15, 2015

Judy A. Robbins
United States Trustee, Region Four

By: /s/ *Robert B. Van Arsdale*
Robert B. Van Arsdale (Va. Bar No. 17483)
Shannon Pecoraro (Va. Bar No. 46864)
Office of the United States Trustee
701 East Broad Street, Suite 4304
Richmond, Virginia 23219
(804) 771-2310
robert.b.van.arsdale@usdoj.gov
shannon.pecoraro@usdoj.gov

By: /s/ *Hugh M. Bernstein*
Hugh M. Bernstein (Md. Fed. Bar No. 23489)
Office of the United States Trustee
101 W. Lombard Street, Suite 2650
Baltimore, MD 21201
(410) 962-4300
hugh.m.bernstein@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 15th day of January 2016, a copy of the foregoing opposition was mailed, first class, postage pre-paid, to:

Jennie L. Anderson
1400 Douglas Street, Stop 1580
Omaha, NE 68179

Oralee Richardson Archer
7774 Old Spec Rd
Peyton, CO 80831

Aspen American Insurance Company
Stites & Harbison PLLC
250 W Main St
Ste 2300
Lexington, Ky 40507

Qurban Barbar
5 Pegasus Dr.
Colts Neck, NJ 07722

Hugh M. Bernstein
Office of UST District of MD
101 West Lombard Street
Suite 2625
Baltimore, MD 21201

Carl E. Black
David G. Heiman
Thomas A. Wilson
Jones Day
North Point
901 Lakeside Avenue
Cleveland, OH 44114

Tyler P. Brown
J.R. Smith
Henry P. (Toby) Long
Justin F. Paget
Riverfront Plaza, East Tower
951 Byrd Street

Richmond, Virginia 23219

Ross Marshall Chinitz
Starr Indemnity & Liability Company
445 Park Ave., 5th Floor
New York, NY 10022

Claims Recovery Group LLC
92 Union Avenue
Cresskill, NJ 07626

Grant Crandall
United Mine Workers of America
18354 Quantico Gateway Drive
Suite 200
Triangle, Virginia 22172

Debra A. Dandeneua
John J. Dedyo
Weil, Gotshal & Manges, LLP
767 Fifth Avenue
New York, New York 10153

Energy& Env Cabinet Commonwealth of Kentucky
Office of General Counsel
2 Hudson Hollow
Frankfort, KY 40601

Joyce Conard
34069 Branch School Rd
Laurel, DE 19956

Barbara and Peter Creighton
Rev
121 Beacon Ln
Columbia, SC 29229

Raniero D'Aversa
Orrick, Herrington & Sutcliffe LLP
51 West 52nd Street
New York, NY 10019

Sandra Davis

P.O. Box 23
Red Jacket, WV 25692

Gary Dellinger
320 Bonham Rd
Bristol, VA 24201

Douglas E. Deutsch
Chadbourne & Parke LLP
1301 Avenue of the Americas
New York, NY 10019

Evan Fleck
Dennis F. Dunne
Eric Stodola
Milbank,Tweed,Hadley & McCloy LLP
28 Liberty Street
New York, NY 10005

Jeffrey B Ellman
Jones Day
1420 Peachtree Street N.E.
Suite 800
Atlanta, GA 30309

Fair Harbor Capital L.L.C.
Ansonia Finance Station
PO Box 237037
New York, NY 10023

Fidelity & Deposit Company of Maryland
Stites & Harbison PLLC
250 W Main St
Ste 2300
Lexington, KY 40507

Robert W. Hamilton
Jones Day
326 John H. McConnell Blvd
Suite 600
Columbus, OH 43215

Troy Hartman

1398 S. Allen Chapel Rd
Kendallville, IN 46755

Stephen H. Hessler
Brian Schartz
Kirkland & Ellis, LLP
601 Lexington Avenue
New York, New York 10022

Dion W. Hayes
Sarah B. Boehm
K. Elizabeth Seig
McGuire Woods, LLP
Gateway Plaza
800 East Canal Street
Richmond, Virginia 23219

IBM Corporation
Attn: Marie-Josee Dube
1360 Rene Levesque W, Suite 400
Montreal, Quebec H3G 2W6
CANADA,

Indemnity National Insurance Company
Stites & Harbison PLLC
250 West Main Street
Suite 2300
Lexington, KY 40507

Mark Jankauskas
Ameriprise Financial
51685 Van Dyke Ave
Shelby Township, MI 48316

Beverly & Walter Jenkins
158 North Branch Rd
Monaca, PA 15061

Harold L. Kaplan
Mark F. Hebbeln
Foley & Lardner LLP
321 North Clark Street

Suite 2800
Chicago, Illinois 60654

Donald Keener, Jr
222 Cottage Ave
Masontown, PA 15461

Mary Ann Kilgore
Union Pacific Railroad Company
1400 Douglas Street, STOP 1580
Omaha, NE 68179

Henry Allen Kinser, Jr
589 Norman Middleton Road
Pennington Gap, VA 24277

Jerrold S. Kulback
Archer & Greiner, P.C.
One Centennial Square
Haddonfield, NJ 08033

Kurtzman Carson Consultants LLC
Attn: Joe Morrow
2335 Alaska Avenue
El Segundo, CA 90245

Lee Supply Co., Inc
305 1st Street
P.O. Box 35
Charleroi, PA 15022

Liquidity Solutions, Inc.
Liquidity Solutions, Inc.
1 University Plaza, Suite 312
Hackensack, NJ 07601

Christine Michele McAnney
Balfour Beatty Infrastructure, Inc.
999 Peachtree Street, NE
Suite 900
Atlanta, GA 30309

Randy Miller

9621 Emory Avenue
Wise, VA 24293

NRAI Services, LLC
160 Greentree Drive
Suite 101
Dover, DE 19904

Gregory F. Pesce
Kirkland & Ellis, LLP
300 North LaSalle
Chicago, Illinois 60654

Alex Rapport
164 Monticello Dr.
Monroeville, PA 15146

Don Reed
621 Arrowhead
Gillette, WY 82718

Roy Wheeler Realty Co
c/o David S. Callaghan, Trustee
1100 Dryden Lane
Charlottesville, VA 22903

Damian S. Schaible
Damon P. Meyer
Davis, Polk & Wardwell, LLP
450 Lexington Avenue
New York, New York 10017

Sierra Liquidity Fund, LLC
19772 MacArthur Blvd # 200
Irvine, CA 92612

Albert Smith
P.O. Box 782
Los Altos, CA 94023

Leo Smith
Custodian for Thomas Smith
335 Summer Walk Lane

Clemson, SC 29631

David C. Stratton
Stratton Law Firm, P.S.C.
PO Box 1530
Pikeville, KY 41502

Timothy Talley
18504 Connie Sue Ct
Abingdon, VA 24211

E. Leroy Tidwell
8324 Bishops Lane
Indianapolis, IN 46217

Sheldon S. Toll
Law Office of Sheldon S. Toll PLLC
29580 Northwestern Highway, Suite 100
Southfield, MI 48034

Gordon Tomb
91 Fairfax Lane
Annville, PA 17003

Travelers Casualty & Surety Company of America
Stites & Harbison
250 West Main Street
Suite 2300
Lexington, KY 40507

Richard Verheij, VP & Secretary
One Alpha Place
Bristol, VA 24202

Thomas Ward
1325 Bolton Street
Baltimore, MD 21217

Roy West
5316 Koontz Drive
Cross Lanes, WV 25313

Westchester Fire Insurance Cmpany

Stites & Harbison PLLC
250 W Main St
Ste 2300
Lexington, Ky 40507

Blanka K. Wolfe
Sheppard Mullin Richter & Hampton LLP
30 Rockefeller Plaza
New York, NY 10112

Zurich American Insurance Company
Stites & Harbison PLLC
250 W Main St
Ste 2300
Lexington, KY 40507

and that, according to the Court's CM/ECF system, the following persons received electronic service:

- David W. Baddley baddleyd@sec.gov
- Kevin W. Barrett kbarrett@baileyglasser.com, mhissam@baileyglasser.com;mchapman@baileyglasser.com
- Peter Barrett peter.barrett@kutakrock.com, lynda.wood@kutakrock.com;sara.abrams@kutakrock.com;charisse.matthews@kutakrock.com
- Paula S. Beran pberan@tb-lawfirm.com, stavenner@tb-lawfirm.com;ltavenner@tb-lawfirm.com;sdigiorgio@tb-lawfirm.com;lnelson@tb-lawfirm.com;dtabakin@tb-lawfirm.com
- Mark A. Black mblack@bmwlaw.com, aday@bmwlaw.com
- Corey Simpson Booker corey.booker@leclairryan.com, elizabeth.slate@leclairryan.com
- Tyler P. Brown tpbrown@hunton.com, tcanada@hunton.com
- Jeffrey Paul Brundage jbrundage@eckertseamans.com, DChrist@eckertseamans.com
- Kristen E. Burgers kburgers@hf-law.com
- James T Burghardt jim.burghardt@moyewhite.com, kim.maynes@moyewhite.com
- William A. Burnett aburnett@williamsmullen.com, ddillon@williamsmullen.com
- Paul K. Campsen pkcampsen@kaufcan.com, jaturner@kaufcan.com
- Michael A. Condyles michael.condyles@kutakrock.com, lynda.wood@kutakrock.com;jeremy.williams@kutakrock.com
- Joseph Corrigan Bankruptcy2@ironmountain.com
- John M. Craig johncraigg@aol.com, russj4478@aol.com
- Karen M. Crowley kcrowley@clrbfirm.com, jbrockett@clrbfirm.com;tturner@clrbfirm.com;clrbfirmecf@gmail.com
- Shannon Eileen Daily sdaily@hunton.com

- Dale A. Davenport ddavenport@hooverpenrod.com, hhutman@hooverpenrod.com;bdriver@hooverpenrod.com;hpnotices@gmail.com;xochoa@hooverpenrod.com
- James K. Donaldson jdonaldson@spottsfain.com, eanderson@spottsfain.com;jwest@spottsfain.com;rchappell@spottsfain.com;tmoore@spottsfain.com;hcutright@spottsfain.com
- S. Miles Dumville mdumville@reedsmith.com, shicks@reedsmith.com;docketingecf@reedsmith.com;dlynch@reedsmith.com
- Augustus C. Epps aepps@cblaw.com, avaughn@cblaw.com
- Louisa A. Fennell fennell.louisa@pbgc.gov
- Evan R. Fleck efleck@milbank.com, atsang@milbank.com;estodola@milbank.com;bgumerove@milbank.com;araval@milbank.com;aleblanc@milbank.com
- Jeremy S. Friedberg jeremy.friedberg@lf-pc.com, ecf@lf-pc.com;pierce.murphy@lf-pc.com
- Kevin J. Funk kfunk@durrettecrump.com, bmcmillen@durrettecrump.com
- John H. Ginsberg ginsberg.john@pbgc.gov, efile@pbgc.gov
- Andrew S. Goldstein AGoldstein@mglspc.com, jcoffman@mglspc.com
- Barbara J. Grabowski bgrabowski@pa.gov
- William A. Gray bgray@sandsanderson.com, sryan@sandsanderson.com;ksmith@sandsanderson.com;dbbankruptcy@gmail.com
- Kelly C. Griffith kgriffith@harrisbeach.com
- Richard E. Hagerty richard.hagerty@troutmansanders.com, sharron.fay@troutmansanders.com;anne.clark@troutmansanders.com;karen.powers@troutmansanders.com
- Gina Baker Hantel agbankcal@ag.tn.gov
- Jason William Harbour jharbour@hunton.com, tcanada@hunton.com
- Michael E. Hastings mhastings@wtplaw.com, twhitt@wtplaw.com
- Dion W. Hayes dhayes@mcguirewoods.com
- Christopher Julian Hoctor choctor@mrcpclaw.com
- Kevin Walker Holt Holt@gentrylocke.com, Higgins@gentrylocke.com
- Carl Alban Howard choward@gebsmith.com
- Vernon E. Inge vernon.inge@leclairryan.com, elizabeth.slate@leclairryan.com
- Britteny N. Jenkins bjenkins@spilmanlaw.com, tbyer@spilmanlaw.com
- Paul G Jennings pjennings@bassberry.com, bankr@bassberry.com
- Chester J Karas CKARAS@pa.gov
- Michael Kwang-Min Kim mkim@stites.com, docketclerkalex@stites.com,jwilliams-parker@stites.com;bearly@stites.com;kgish@stites.com;sfeatherston@stites.com
- Kevin A. Lake klake@mcdonaldsutton.com
- Stephen E. Leach sleach@hf-law.com, ndysart@hf-law.com
- Henry Pollard Long hlong@hunton.com, tcanada@hunton.com
- John H. Maddock III jmaddock@mcguirewoods.com
- Richard C. Maxwell rmaxwell@woodsrogers.com, hstewart@woodsrogers.com
- Kenneth D. McArthur kdm@pietragallo.com, rjp@pietragallo.com;ms@pietragallo.com
- Christine H. McCarthy cmccarthy@btlaw.com

- James Grant McGuire gmcguire@campbellwoods.com, phammack@campbellwoods.com;cjones@campbellwoods.com
- Robert P. McIntosh Robert.McIntosh@usdoj.gov, USAVAE.RIC.ECF.CIVIL@usdoj.gov;SJohnston1@usa.doj.gov
- Jennifer McLain McLemore jmclemore@cblaw.com, avaughn@cblaw.com;gnatella@cblaw.com;cnichols@cblaw.com
- Edward J. McNelis emcnelis@rawlsmcnelis.com, jarcher@rawlsmcnelis.com
- Marcello M. Mollo marcello.mollo@usdoj.gov
- Carol E. Momjian cmomjian@attorneygeneral.gov
- Erika L. Morabito emorabito@foley.com
- Thomas Joseph Moran tmoran@setliffholland.com, wcabell@setliffholland.com
- Michael D. Mueller mmueller@cblaw.com, avaughn@cblaw.com
- Ronald A. Page rpage@rpagelaw.com, rpage@ecf.inforuptcy.com;pagebankruptcy@gmail.com;ronpagebankruptcy@gmail.com
- Justin F. Paget jpaget@hunton.com, tcanada@hunton.com
- Peter M. Pearl ppearl@spilmanlaw.com, scormany@spilmanlaw.com
- Shannon Pecoraro Shannon.pecoraro@usdoj.gov, june.e.turner@usdoj.gov;Theresa.Mack@usdoj.gov
- Robyn Danielle Pepin rpepin@glasserlaw.com, pjmecf@glasserlaw.com
- Richard Thomas Pledger rpledger@setliffholland.com, tmoran@setliffholland.com;kallen@setliffholland.com
- Patricia Williams Prewitt pprewitt@lockelord.com
- William Daniel Prince wprince@t-mlaw.com, jseay@t-mlaw.com
- Robert Frederick Ritchie rritchie@atg.state.il.us
- Judy A. Robbins USTPRegion04.RH.ECF@usdoj.gov
- David Mitchell Ross david.ross@wilsonelser.com, timothy.wheeler@wilsonelser.com;daniel.flores@wilsonelser.com
- David R. Ruby druby@t-mlaw.com, bankruptcyassistant@t-mlaw.com;druby@ecf.epiqsystems.com
- Denyse Sabagh dsabagh@duanemorris.com
- Troy Savenko tsavenko@kv-legal.com, djenkins@kv-legal.com
- John Henry Schanne schannej@pepperlaw.com, jaffeh@pepperlaw.com
- Sheila R Schwager sschwager@hawleytroxell.com, cdavenport@hawleytroxell.com
- William H. Schwarzschild tschwarz@williamsmullen.com
- Richard D. Scott richard@rscottlawoffice.com
- Mark D. Sherrill mark.sherrill@sutherland.com
- Elliot Smith elliot.smith@squirepb.com, Karen.graves@squirepb.com
- John Ronald Smith jrsmith@hunton.com
- Mark Henry Michael Sosnowsky mark.sosnowsky@dbr.com, Kristin.Going@dbr.com;jennifer.roussil@dbr.com;daniel.northrop@dbr.com
- Daniel D. Sparks dds@csattorneys.com, jgguier@csattorneys.com;bdb@csattorneys.com;wlt@csattorneys.com;dml@csattorneys.com
- Cullen Drescher Speckhart cspeckhart@wolriv.com, scigliano@wolriv.com
- Adam M. Spence adam@spencebucklerlaw.com
- Lisa Bittle Tancredi ltancredi@gebsmith.com

- Lynn L. Tavenner ltavenner@tb-lawfirm.com, sleadbeater@tb-lawfirm.com;sdigiorgio@tb-lawfirm.com;lnelson@tb-lawfirm.com
- Roy M. Terry rterry@sandsanderson.com, sryan@sandsanderson.com;dbbankruptcy@gmail.com
- Alison Ross Wickizer Toepp atoepp@reedsmith.com, dlynch@reedsmith.com;dflippen@reedsmith.com;docketingecf@reedsmith.com
- Dylan G. Trache dylan.trache@nelsonmullins.com, robert.ours@nelsonmullins.com
- Robert B. Van Arsdale Robert.B.Van.Arsdale@usdoj.gov
- Christian K. Vogel kvogel@vogelandcromwell.com
- Jennifer J. West jwest@spottsfain.com, rchappell@spottsfain.com;tmoore@spottsfain.com;eanderson@spottsfain.com;jolmsted@spottsfain.com;jdonaldson@spottsfain.com;hwilson@spottsfain.com
- Robert S. Westermann rwestermann@hf-law.com, rmcburney@hf-law.com;rmcburney67@gmail.com
- David B. Wheeler davidwheeler@mvalaw.com
- Bruce W. White gailwhite28@gmail.com, brucewwhite@gmail.com;brucebwhite@gmail.com
- Jeremy S. Williams jeremy.williams@kutakrock.com, lynda.wood@kutakrock.com
- Scott C Williams swilliams@manierherod.com, mcollins@manierherod.com
- Michael Gregory Wilson mike@mgwilsonlaw.com
- Gordon S. Woodward gwoodward@schnader.com
- Miles Jarrad Wright mjwright@dimuro.com, ccoggins@dimuro.com;smodeste@dimuro.com;khauck@dimuro.com
- Peter G. Zemanian pete@zemanianlaw.com

/s/ *Hugh M. Bernstein*
Hugh M. Bernstein