UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

AGWAY, INC. CASE NO. 02-65872 through 02-65877

Chapter 11

Debtor Jointly Administered

IN RE:

AGWAY GENERAL AGENCY, INC.

Debtor

IN RE:

BRUBAKER AGRONOMIC CONSULTING SERVICE LLC

Debtor

IN RE:

COUNTRY BEST ADAMS, LLC

Debtor

IN RE:

COUNTRY BEST-DEBERRY LLC

Debtor

IN RE:

FEED COMMODITIES INTERNATIONAL LLC

Debtor

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently before the Court is a motion ("Compensation Motion") filed on March 10, 2003, on behalf of Agway, Inc. ("Agway") and certain of its direct and indirect subsidiaries, as debtors and debtors in possession (collectively, the "Debtors") seeking an order approving certain modifications to Agway's employee compensation programs pursuant to §§ 363(b), 363(c) and 105(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"). A Statement of Position ("Committee's Statement") of the Official Unsecured Creditors' Committee ("Committee") was also filed on March 10, 2003, expressing support for the Compensation Motion "with some degree of reluctance, but with the knowledge that this issue had to be laid to rest for this case to move ahead."[1] On March 21, 2003, a response was filed on behalf of General Electric Capital Corporation, as Agent for certain pre- and post-petition lenders, indicating that in its opinion the Compensation Motion "is fair and reasonable in light of the circumstances." Opposition to the Compensation Motion was filed on March 21, 2003, on behalf of what is referred to as an "unofficial unsecured creditors' committee" comprised of Agway

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[1] On October 22, 2002, the Court heard oral argument on the Committee's motion ("Reconsideration Motion") seeking reconsideration of certain first day orders, including one authorizing the Debtors to pay prepetition wages, compensation, and employee benefits, including "special incentive programs" in the approximate aggregate amount of $4,800,000 and "paid time off" obligations totaling $9,100,000. The Committee sought information concerning, *inter alia*, "any bonus or incentive programs, or any severance or pay to stay programs [to the extent they] are assumed, approved or implemented." *See* ¶ 34 of Committee's Reconsideration Motion. That aspect of the motion has been carried on the Court's calendar along with Agway's motion now under consideration. According to the Committee, "[t]he compromise embodied within the Compensation Motion resolves all remaining issues raised by the motion for reconsideration." *See* Committee's Statement at 5 n. 1.

retirees ("Retirees"), some of whom allegedly ran the company for 30 years.[2] Agway filed a response to their opposition on March 25, 2003.

The Compensation Motion was heard at the Court's regular motion term in Utica, New York, on March 25, 2003. Following oral argument, the Court adjourned the Compensation Motion to April 1, 2003, in Syracuse, New York, in order for the Debtors to provide the Retirees with additional information. The Retirees, having reviewed the materials provided by Agway, submitted a Confidential Supplemental Affidavit to the Court on March 31, 2003, expressing its continued opposition to the Compensation Motion.

Following further oral argument on April 1, 2003, the Court indicated that it would take the matter under advisement, affording the parties an opportunity to file memoranda of law by April 15, 2003, with particular focus on the statutory basis for the Compensation Motion.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(A) and (M).

BACKGROUND

[2] According to the Debtors, although there are approximately 5,100 such retirees, there are only an estimated 500 retirees that actually are creditors in the Debtors' cases.

The Debtors filed voluntary petitions pursuant to chapter 11 of the Code on October 1, 2002. Agway is an agricultural cooperative engaged in a number of business activities and it and its subsidiaries, to the extent they have not been liquidated during the pendency of the case, have continued to operate and manage their businesses as debtors in possession pursuant to Code §§ 1107(a) and 1108.

Prepetition, Agway had in place various compensation arrangements for its employees, including base salary, incentive compensation, severance benefits, supplemental severance benefits for certain key employees and special separation compensation arrangements for the most senior executives. There were also allegedly retention and bonus plans for employees of businesses that were expected to be discontinued or sold such as the Agronomy and Seedway businesses, as well as Telmark.[3]

According to Debtors' counsel, following extensive negotiations with the Committee over a five month period, the proposed compensation package presented to the Court for its approval represents a downward modification from that which existed at the time of the Debtors' filing and is expected to result in an estimated savings to Agway's estate of approximately $5.0-5.5 million.[4] *See* Compensation Motion at ¶ 18 and Exhibit A[5], attached to Committee's Position Statement.

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[3] The Agronomy and Seedway businesses were sold postpetition to Growmark, Inc. upon approval by the Court on November 13, 2002. The Court approved the sale of substantially all of Telmark's assets to Wells Fargo Financial Leasing, Inc. on February 27, 2003.

[4] The Committee points out that the savings of approximately $5.0 to 5.5 million "does not acknowledge the $5.5 million KERP ('key employee retention plan') payments originally sought by Agway and later dropped at the Committee's insistence." *See* Committee's Position Statement at 9 n. 5.

[5] Exhibit A provides a comparison of costs under the original proposed agreement and under the final agreement, as well as a summary of the various payment terms under the proposed

The Committee describes a reduction in bonus arrangements for "discontinued operations," which include the Agronomy and Seedway businesses. The retention bonuses for certain employees of those businesses were reduced by 20% and are now general unsecured claims. Fifty percent of the remaining 80% will be paid immediately in cash, after crediting $458,862 in payments received before the petition date, "with the balance being 'earned' by the employees based upon Agway's realization of the deferred balance of the Growmark purchase price." *Id.* at ¶ 11. In addition, the Committee alleges that it was able to negotiate a 20% reduction of the Telmark retention bonuses, originally estimated at $1,744,756, and the capping of the pro rata incentive compensation payment at $1,542,474, a decrease from $1,888,272 for seventeen Telmark employees.[6]

According to the Committee, Agway had wanted to keep base salary and incentive compensation arrangements in place and also to provide for a substantial bonus or retention plan for fifty key employees at an estimated cost of $5,428,000. The Committee objected to this and also took issue with the payment of $545,819 in special bonuses paid to seven employees in September 2002 on the eve of bankruptcy as a reward to those employees who had assisted with "readying" Agway for the bankruptcy filing.

Agway agreed, at the Committee's insistence, to drop the bonus program and to make the "'incentive' piece of Agway's traditional preexisting compensation . . . more contingent upon

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compensation agreement.

[6] According to Debtors' counsel, employees of its energy and leasing businesses, including Telmark, although nondebtors, agreed to a reduced compensation package.

performance than it had been in the past."[7] *Id.* at ¶ 17. Also eliminated is the long term incentive plan payments to six members of senior management at an estimated savings of $1,510,978.[8] With respect to the "bonuses" paid in September 2002 to seven employees, the Committee asserts that it insisted on the recapture of these monies through an offset against the first incentive or severance payments due. Accordingly, these payments will be deducted from the amounts such employees would otherwise be entitled to for fiscal year 2003. If the 2003 target incentive is not achieved and the employee is unable to apply the September payment against the 2003 target incentive, it will be deducted from the employee's 2004 target incentive payment.

At the hearing on March 25, 2003, Guy A. VanBaalen, Esq, of the office of the United States Trustee ("UST"), indicated that he too had concerns with the application of the September payment to an employee's 2004 target incentive. An agreement was reached with Agway and the Committee to further modify the Compensation Motion. *See* Letter of Judy G.Z. Liu, Esq., of the law firm of Weil, Gotshal & Manges LLP, dated March 19, 2003. Under the agreement, 50% of an employee's 2003 target incentive will be paid in July 2003. The remaining 50% will be paid on the earliest to occur of

> (I) the sale of the business unit for which the employee performs services, (ii) the involuntary termination of the employee, and (iii) the

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[7] Under the current program, referred to by Debtors as the "Management Target Annual Incentive Program," key employees receive a straight salary component and an incentive component which is based on their meeting certain performance targets as set for their respective divisions. According to the Debtors, it is "designed with the objective of providing total compensation to the employee at market levels if the target is met." *See* Debtors' Motion at 8. Furthermore, employees are entitled to receive all or a portion of the target incentive if separated from Agway. Also certain managers are eligible for continuation of employee benefits following separation of employment.

[8] It is unclear whether these savings include a "change of control" payment to the president of Telmark of $230,022 which was eliminated.

> confirmation of a chapter 11 plan; provided , however, that solely as to the employees of Agway Energy, the date "December 26, 2003" will be an additional event for purposes of determining the earliest date upon which such employees' remaining FY '03 Target Incentive will be paid.

See id.

The parties also agreed that 75% of the "paid time off" obligations to employees for 2002 would be treated as a prepetition unsecured claim and 25% as a postpetition claim. *See* Committee's Position Statement at ¶ 20.

The Committee indicates that its support for the Compensation Motion "is dampened by its recognition that Agway's preexisting compensation arrangements with its employees were already quite generous and that Agway management's generosity with itself may be an affront to general unsecured creditors . . . ." *See* Committee's Position Statement at ¶6. Nevertheless, according to Committee's counsel, the proposed compensation package represents a delicate balance between overcompensation and not giving enough to the employees to provide an incentive for remaining in the employment of the Debtors postpetition. It was represented to the Court that if it turns out that there is going to be a complete liquidation of the Debtors' businesses, it is essential that it be on a "going concern" basis so as to maximize value for the unsecured creditors. The Committee notes that these reductions were obtained without the cost of depositions and litigation involving, for example, alleged fraudulent transfers of monies paid to certain employees in September 2002, immediately prior to filing. It is also pointed out that while a significant portion of the package consists of severance, it is hoped that little of that will be paid out if the employees are retained in the process of liquidation of any of the ongoing businesses.

With respect to Agway's severance programs, there are three according to Michael R.

Hopsicker, Agway's current Chief Executive Officer ("Hopsicker"). These include:

> a. "Separation Compensation": covers four (4) current and two (2) former senior executives based on individual compensation agreements adopted annually in the first few months of Agway's fiscal year.[9]
>
> b. "Additional Retirement Benefit": the ARB program was adopted by the Board of Directors in February 2002, effective for separations on and after April 1, 2002. The ARB, which benefits all Agway employees, replaced Agway's Severance Pay program which also benefitted all employees. Program modifications adopted in February 2002 provide for benefits to be paid by Agway's over-funded pension plan, thereby preserving Agway cash.
>
> c. "Supplemental Severance": memorialization in August 2002 of long standing practice of providing additional severance to certain executives and key employees upon involuntary termination without cause.[10] Historical payments have ranged from 50% to 200% of base salary. The Supplemental Severance Program that the Company is proposing proposes benefits ranging from 50% to 100% of base salary, less ARB payments.

See Affidavit of Hopsicker, sworn to April 1, 2003, at 3-4.

Agway's Compensation Motion seeks Court approval of "a" and "c" above. Severance payments for employees of continuing operations has been reduced and capped at $6.4 million. See Committee Position Statement at ¶18. The Committee explains that under the modification, it traded the certainty of paying $5.5 million to key employees to stay for the probability that $6.4 million will never be paid because of the likelihood that key employees will not be involuntarily terminated should a particular subsidiary be sold, as it is reasonable to believe that the purchaser would wish to keep key employees on in some capacity.

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[9] Agway's fiscal year ends on June 30th of each year.

[10] This particular benefit allegedly applies to approximately fifty individuals.

Finally, Agway's previous CEO, Donald P. Cardarelli, who was terminated effective April 18, 2003, is to receive a lump sum cash payment in the amount of $1,026,740 as his severance. *See* Exhibit A, attached to Debtors' Compensation Motion. According to the Debtors, this represents 22 months of salary. *See* Debtor's Compensation Motion at 12. He was not entitled to any annual incentive for the 2003 fiscal year or any long-term incentive payment. *See* Exhibit A, attached to Debtors' Compensation Motion. It is alleged that this is less than half of what he was originally entitled prior to the modifications. *See* Letter from Hopsicker, dated March 7, 2003, attached as Exhibit C of Retirees' Opposition, received March 21, 2003.

At the hearing on March 25, 2003, the Court heard arguments from the attorney for the Retirees. He argued that insufficient information had been provided for there to be an informed decision about the Compensation Motion. He raised questions with respect to when the various compensation packages had been effected and whether they had been approved by the Debtors' Board of Directors. He also questioned why their approval could not wait until plan confirmation. At the hearing on April 1, 2003, having been provided with extensive documentation from the Debtors, he expressed concerns about what he referred to as "corporate excess" over recent years at a time when Agway was experiencing a downward turn in its gross revenues. He asserted that between 1994 and 2000 management compensation had increased by 200% and that the "corporate culture" had changed and Agway had become "a Wall Street compensation package firm" when it was merely "an agricultural co-op in upstate New York."

DISCUSSION

Last year the Employee Abuse Prevention Act of 2002 ("EAP Act") was introduced unsuccessfully in Congress to "protect employees and retirees from corporate practices that deprive them of their earnings and retirement savings when a business files for bankruptcy . . . ." H.R. 5221, 107th Cong., 2d Sess.; S. 2798, 107th Cong., 2d Sess. (2002). Whether or not this proposed legislation will again be considered in the current Congress is unknown. However, in the wake of the national uproar over such mega filings as Enron and WorldCom, the Court feels it necessary to approach any request concerning severance packages and management stay bonuses prior to plan confirmation with caution despite the lack of statutory guidance that the proposed EAP Act otherwise might have provided.[11]

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[11] For example, the proposed EAP Act would have amended Code § 503 to require that a transfer made to an insider of the debtor for the purpose of inducing such person to remain with the debtor's business would not be allowed

> absent a finding by the court based on evidence in the record that (i) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation; (ii) the services provided by the person are essential to the survival of the business . . .

Furthermore, under the EAP Act, Code § 503 would also have prevented a severance payment to an insider of the debtor, unless

> (i) the payment is part of a program that is generally applicable to all full-time employees; and (ii) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made . . . .

At the hearing on April 1, 2003, the Court inquired about the statutory basis for Agway's motion and whether it was actually a motion pursuant to Code § 365 seeking to assume certain prepetition executory contracts or pursuant to Rule 9019 of the Federal Rules of Bankruptcy Proceeding to approve a settlement of the Committee's Reconsideration Motion. Agway's counsel had filed the motion in reliance on Code § 363(b), § 363(c) and § 105(a). The Court asked that the parties brief the issue and upon review of the memoranda of law submitted on behalf of Agway and the Committee, it is clear that other bankruptcy courts asked to approve key employees retention programs and severance packages, such as proposed by these Debtors, have done so under the statutory umbrella of Code § 363(b). *See In re Aerovox, Inc.*, 269 B.R. 74, 80 (Bankr. D.Mass. 2001) (citations omitted); *see generally, In re Dornier Aviation (North America)*, Inc., 2002 WL 31999222 at *8 (Bankr. E.D.Va.) (noting that such agreements do not fall within the category of agreements that are considered "in the ordinary course of business" and require notice to creditors and court approval, particularly when they involve executives or other key employees, whether they be existing employment policies or new severance or retention agreements). It is under that statutory umbrella that the Court will consider Agway's Compensation Motion.

"The determination of whether to approve such plans turns on the facts and circumstances of each particular case." *In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 154 (D. Del. 1999) (citations omitted). The Debtors' business judgment, as applied to discretionary actions or decisions of corporate directors, is to be given considerable weight by this Court, sitting "'as an overseer of the wisdom with which the bankruptcy estate's property is being managed . . . and not, as it does in other circumstances, as the arbiter of disputes between creditors and the estate.'" *Aerovox*, 269 B.R. at 80,

quoting *In re Orion Pictures Corp.*, 4 F.3d 1095, 1099 (2d Cir. 1993). As long as the Court finds the compensation program fair and reasonable and the Debtors' business decision sound and not based on "bad faith, or whim or caprice," it should be approved. *See In re Logical Software*, 66 B.R. 683, 686 (Bankr. D. Mass. 1986), *remanded sub nom*. *Infosystems Technology, Inc. V. Logical Software, Inc.*, 1987 WL 13806 (D. Mass. 1987) (citation omitted).

In this case, not only does the Court have the request of the Debtors to approve the compensation packages, it also has the Committee's statement of support for the agreement which resulted from several months of negotiations with the Debtors. What the Court does not have, however, is any evidence of approval by the Debtors' Board of Directors in the exercise of its business judgment. The Retirees allude to approval by the Debtors' Board of Directors on August 28, 2002. However, the compensation plan for which Court approval is currently sought was negotiated by the Debtor and the Committee sometime after October 15, 2002, when the Committee first requested reconsideration of certain first day orders entered in the case.

In *Aerovox* the debtor sought authority pursuant to Code § 363(b) and § 105(a) to implement a key employee retention program consisting of a bonus plan for seventeen middle management employees and a severance package for four executives. *See Aerovox*, 269 B.R. at 75. The debtor's motion was opposed by the creditors' committee and an evidentiary hearing was held to determine whether to approve the program in full, in part or not at all. The debtor and the committee were able to reach a stipulation concerning the retention program for the middle management employees; however, they were unable to reach agreement concerning the severance package for the four senior executives. *Id.* Like the Debtors herein, the goal of the debtor in *Aerovox* was to find a buyer for the debtor's

assets while maintaining the going concern value of the debtor.

The court in *Aerovox*, *inter alia*, heard the testimony of one of the debtor's directors, who had served on its board for four years. *Id.* at 78. He testified about the collective experience of the entire board of directors, including five "outside directors." He testified that the board's decision to approve the proposed compensation package was based on their collective business judgment and went on to explain in detail the due diligence conducted by the board in reaching its decision. *Id.* at 79.

The matter now under consideration by this Court is to be distinguished from that in *Aerovox* in that the Committee herein has agreed to the entire modified compensation package presented by Agway allegedly in reliance on Agway's business judgment. However, there is nothing in Agway's papers to indicate that the proposed modifications received the prior acceptance and approval by a majority of disinterested Board members. The Court also has no information concerning whether any of the members of the Board are directly impacted by the modifications. The Court also has no evidence of the due diligence conducted in this regard. Agway and the Committee have indicated that the proposed compensation package represents a <u>downward</u> modification of that which existed at the time of the filing; nevertheless, the Court is left without any basis for determining whether it is based upon sound business judgment under the facts and circumstances of this case. Accordingly, the Court deems it appropriate to schedule an evidentiary hearing at which testimony may be presented by at least one member of Agway's Board of Directors, who shall be subject to cross-examination, on the issue of sound business judgment as referenced above.[12]

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[12] In the alternative, the Court will accept an affidavit from a disinterested and authorized member of Agway's Board of Directors setting forth the basis for the Board's decision to approve the

Based on the foregoing, it is hereby

ORDERED that an evidentiary hearing on Agway's Compensation Motion shall be held on Wednesday, the 7th day of May 2003 at 9:00 a.m. at the U.S. Courthouse, 10 Broad Street, Utica, New York 13501.

Dated at Utica, New York

this 21st day of April 2003

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

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compensation package, as modified post-petition. The Court will review said affidavit without the need for a further hearing upon written acceptance of same by counsel for the Committee, counsel for the Retirees and the UST. Indication of acceptance in lieu of a hearing shall be communicated to the Court at least 24 hours prior to the date of the hearing.