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EXECUTIVE COMPENSATION IN CHAPTER 11 BANKRUPTCY CASES: HOW MUCH IS TOO MUCH?

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

APRIL 17, 2007

Serial No. 110–11

Printed for the use of the Committee on the Judiciary



Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

34–755 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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EXECUTIVE COMPENSATION IN CHAPTER 11 BANKRUPTCY CASES: HOW MUCH IS TOO MUCH?

TUESDAY, APRIL 17, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:34 a.m., in Room 2141, Rayburn House Office Building, the Honorable Linda Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Conyers, Johnson, Delahunt, Cohen, Cannon, Jordan, Feeney, and Franks.

Ms. SÁNCHEZ. This hearing of the Committee on the Judiciary Subcommittee on Commercial and Administrative Law will come to order.

Before we begin today's hearing, out of respect for the victims and families of yesterday's tragedy at Virginia Tech, I would like to begin this hearing by observing a brief moment of silence for those victims and their families.

Thank you.

I will now recognize myself for a short statement.

As a result of many Chapter 11 bankruptcy proceedings, "the rich are getting richer while the poor are getting poorer," as stated in a recent press release by the Northwest Flight Attendants Union.

This is a compelling summary of a recent phenomenon that should concern all of us. Chapter 11 of the Bankruptcy Code was originally enacted to give all participants an equal say in how a business, struggling to overcome financial difficulties, should reorganize. Unfortunately, this laudable goal does not reflect reality, especially for certain participants in Chapter 11.

This problem is clearly illustrated by the numerous Chapter 11 cases in which chief executive officers receive outrageously large compensation and bonus packages while they simultaneously slash the wages, benefits and even jobs of the workers who are the backbone of those businesses.

"All too often," as one bankruptcy judge recently observed, executive retention plans "have been widely 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."

This is an issue that deserves more attention from this Committee.

While I commend my colleagues on both sides of the aisle, Ranking Member Chris Cannon and Representative Bill Delahunt, for their efforts to address certain aspects of this problem, much more, unfortunately, still needs to be done.

Here is just one example. The chief executive officer of UAL Corporation, the parent of United Airlines, received compensation worth $39.7 million in 2006, just after UAL emerged from 3 years of Chapter 11 bankruptcy protection. During the course of its bankruptcy, however, UAL terminated pensions for 120,000 workers and shifted $5 billion in pension obligations to the PBGC, resulting in the largest pension default in the history of the United States, according to the Associated Press.

These inequalities are astounding. The Executive Compensation Committee of the American College of Bankruptcies recently issued a report noting that employee retention and incentive compensation programs present a "daunting challenge." It continued, there are few issues faced by Chapter 11 debtors that are more difficult and potentially contentious than management compensation issues.

Accordingly, I look forward to hearing the testimony of the witnesses at today's hearing. To help us further explore these issues, we have a truly notable witness panel.

We are pleased to have Damon Silvers, Associate General Counsel for the AFL-CIO; Antoinette Muoneke, a United Airlines flight attendant and representative of the Flight Attendants Association; Mark Wintner, expert on employee benefits and executive compensation; and Richard Levin, vice chair of the National Bankruptcy Conference.

Rest assured that it is my intention to consider in future hearings other aspects of the imbalance that exists in Chapter 11 concerning management and labor, particularly with respect to collective bargaining agreements and retirement benefit. Additionally, there are other issues in bankruptcy that should be addressed by this Committee, including the compensation of trustees in Chapter 7 cases.

It has been many years since Congress has examined these issues. I know Committee Chairman John Conyers shares my concern about the urgent need to refocus and conduct a long overdue analysis of Chapter 11 and how it impacts workers.

I would now like to recognize my colleague, Mr. Cannon, the distinguished Ranking Member of the Subcommittee, for any opening remarks he may have.

Mr. CANNON. Thank you, Madam Chair.

Today we are considering an issue of common interest regarding how to best compensation executives who must rescue and rehabilitate enterprises contributing products, services and jobs to our society under Chapter 11 of the Bankruptcy Act.

Chapter 11 seeks to reconcile many independent interests, just like other chapters of the Bankruptcy Code, but the paramount aim of Chapter 11 is to save companies that can still be saved.

To reach that aim, we have to strike the right balance between conserving founder companies' resources and spending enough of those resources to keep on track the management teams that can

turn those companies around and return them to prosperity. If we don't get that right, the entire Chapter 11 system is undermined.

In the Bankruptcy Abuse and Consumer Protection Act, we enacted a number of limitations on executive compensation in Chapter 11 settings. Several of these limitations, codified in section 503C1 of the act, are known as Key Employee Retention Plan or KERP's provisions.

Under the KERP's provisions, subject to court approval, special retention packages designed to induce key executive personnel to stay on at a Chapter 11 company can now be made only when they are, first, essential to the retention of an individual because the individual has a bona fide job offer from another business at an equal or greater salary; two, essential to the survival of the business; and, three, do not exceed certain levels indexed to prior year nonmanagement pay executive retention bonuses.

Prior to enactment, concerns were noted about these provisions; the proponents offered that they were necessary to prevent Enron-type abuses. Others, however, including me, believe that they are unduly restrictive. I believe that such tight restrictions on management compensation are merited only where there is evidence of insider negligence, mismanagement or fraudulent conduct that contributed in whole or in part to the company's insolvency.

Otherwise, I believe we would run the risk of hampering companies' best chance to survive and prosper by failing to retain talented and responsible management already intimately familiar with the company. Some say that if we focus too much on such considerations, we run the risk of paying management too much to stay while potentially cutting labor pay and benefits.

In the last Congress, such arguments led to the introduction of legislation that would have extended the already too restrictive KERP's provisions to performance and incentive pay bonuses and other forms of executive compensation essential to competing in the market for executive personnel.

That argument is false. It is critical that a Chapter 11 debtor be able to retain management that is dedicated to maintaining the company's value, not out of self-interest of executives but for the benefit of all of its creditors, investors, employees and stakeholders. All too often, companies that fail to reorganize successfully are converted to Chapter 7 for liquidation, where not only do the creditors receive pennies on the dollar, but employees face a much bleaker prospect of losing their jobs.

Courts have now had experience implementing the KERP's provisions and companies have attempted to survive under them. This hearing presents a good opportunity to see whether the provisions are working or are counterproductive.

What the record shows is that in practice the KERP's provisions have generated some controversy. In the Dana Corp. case, for example, the bankruptcy court in Manhattan denied an initial executive compensation plan.

That plan consisted of the following: a base salary for the CEO of $1.552 million and of $500,000 to $600,000 for other executives; an annual incentive program or AIP that could have paid the executives anywhere from $336,000 to $528,000 and the CEO up to $2 million; a completion bonus that would provide a minimum of

$400,000 to $560,000 for executives and $3.1 million for the CEO upon the effective date of the plan of the reorganization as well as uncapped bonus based on the total enterprise value of the debtors 6 months after the effective date of the reorganization plan; and finally, four, a severance non-compete package worth more than $167,000 per month for up to 18 months if the CEO was terminated for anything other than cause.

Without knowing more, one can imagine that such a plan might be unduly generous. The court found it so, focusing largely on the conclusion that the plan's guaranteed payments to executives could only be treated as retention payments subject to section 503C1 rather than incentive payments subject to a business judgment rule under the sub-provisions of section 503C3.

In November 2006, the court approved a modified and more modest plan. The approved plan was found to be an incentive plan escaping the KERP's provisions, but only because the court reviewed the plan holistically and did not draw on the features of the plan that were similar to those previously rejected for violating the KERP's provisions. The court emphasized that merely because a compensation plan has some retentive effect does not mean that the plan overall is retentive rather than incentivizing in nature.

Under this approach, if a plan is on the whole incentivizing in nature, it may not be subject to otherwise applicable KERP's provisions. Some believe that this approach opens up a loophole in the Bankruptcy Code and that we should close that loophole. Others may believe that it shows all the more that restrictions like KERP's provisions need to be imposed on incentive pay and other forms of executive compensation.

I believe that the Dana Corp. case shows in one important, real-life example how the KERP's provisions have underserved the needs ot Chapter 11 companies for flexibility in structuring executive compensation packages that can keep the right management teams in place. I believe that it shows that experienced bankruptcy courts see the same thing and are straining to interpret the code in a way that would help keep Chapter 11 companies from becoming Chapter 7 economic shipwrecks.

I look forward today to hearing from all of the witnesses on these and other cases as we hear their views on how the KERP's provisions are working or not working in practice and I hope this hearing helps us better understand the importance of not undercutting the needs of Chapter 11 companies for essential leadership.

Thank you, Madam Chair. I yield back.

Ms. SÁNCHEZ. I thank the gentleman for his statement.

I would now like to recognize Mr. Conyers, a distinguished Member of the Subcommittee and the Chairman of the Committee on the Judiciary.

Mr. Conyers?

Mr. CONYERS. Thank you so much, Madam Chairperson.

Let me tell you how pleased I am that you and Chris Cannon, your Ranking Member, Bill Delahunt from Massachusetts, are all looking at something that hasn't been examined for some 20 or more years.

What we are talking about is the inequality in incomes in this great country of ours. I want to be the first to say it here: the rich

are getting richer, the poor are getting poorer. One percent of the top 300,000 people make nearly, or aggregate nearly as much as the 150 million others in the tax scheme in the United States of America.

So we are looking at this section 11 for the first time and I want to congratulate you.

I would like unanimous consent to have entered in at the end of my comments the "Nation" article of April 23, 2007, entitled, "A Time to Act on Inequality."

Ms. SÁNCHEZ. Without objection, so ordered.

[The submission from Mr. Conyers follows:]

April 23, 2007 The Nation since 1865. 3
PRINTED APRIL 4 VOLUME 284, NUMBER 16

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EDITORIALS

Time to Act on Inequality

In newsrooms, a favorite excuse used by reporters and editors to kill a story is to say, "We already had that." Why waste space on old news? Readers already know that income inequality is growing ferociously in America. Some indefatigable reporters, however, bull their way past the objections. David Cay Johnston of the *New York Times* recently came up with new facts that make the familiar old story shocking again. The top 1 percent of Americans are now getting the largest share of national income since 1928. And a mere 300,000 are now getting almost the same income as 150 million others on the bottom of the wage ladder.

The wage gap has nearly doubled since 1980, the dawn of the conservative era. The deterioration of equitable income in American society is not over. It continues to get much worse. The top 10 percent—the people earning roughly $100,000 a year and higher—now get 48.5 percent of total income. Not surprisingly, average incomes for the bottom 90 percent are down slightly. These numbers are from the Internal Revenue Service for 2005, and experts agree they understate the disparities.

This country is already in the thick of another presidential election, and we need to learn more. Might we hear the candidates address this national scandal and say concretely what they intend to do about it? Republicans, we know, will duck and dodge. But Democratic hopefuls are not exactly speaking out on inequality either. John Edwards is an admirable exception; he has declared unilaterally that income inequality is no longer a taboo subject.

Voters understand what's happening and they are overwhelmingly distressed, as the Pew Research Center's recent comprehensive polling confirmed. Some 73 percent of Americans agree with this statement: "Today it's really true that the rich get richer while the poor get poorer." More striking is the fact that two-thirds of affluent families (incomes of $75,000 and higher) agree.

The public has shifted its political attitudes significantly, according to Pew, returning to the sense of connectedness that prevailed before it was weakened by many years of conservative ideology. If you ask now whether government has obligations to take care of people who can't care for themselves, 69 percent agree, up from 57 percent at the low point of 1994, when Republicans captured Congress. These social sensibilities are doubtless related to what people feel in their own lives. Some 44 percent say they "don't have enough money to make ends meet." That is, nearly half the country feels financially troubled.

Put aside economic theory and income statistics. Inequality has a human face, and its expression is one of stressful anxiety. In a survey last fall, Lake Research Partners asked nonsupervisory workers (who make up about 80 percent of the workforce) what worries them most in everyday life. Not being able to afford healthcare when you or your family needs it: 77 percent. Not having enough money for retirement: 77 percent. Losing your job and not being able to find one with the same pay and benefits: 65 percent. Having your standard of living slip further: 68 percent. Losing your home or never owning a home: 59 percent. (For a more intimate portrait of how inequality devours the social fabric, read Eyal Press in this issue on poverty's move to the suburbs.)

The Democrats in Congress have taken modest but valuable first steps toward reversing wage inequality and economic fears by introducing legislation to raise the minimum wage and make it easier to form a union. Americans are clearly ready for larger and more fundamental responses, everything from progressive tax reform to national industrial policy on trade and aggressive public investment in people's security. Only with big changes can we hope to achieve a society distinguished not by the number of millionaires but by the rising level of well-being of all its citizens.

Mr. CONYERS. Now, too often we have got executives receiving extravagant multi-million-dollar bonus packages, stock options, and golden parachutes, while the workers at the same time are being drastically reduced in their pay, their pensions, their health care. And sometimes, of course, they lose everything.

We are just finally getting around to it and I am so proud of this Subcommittee on Commercial and Administrative Law, that we are examining this question. It is way, way overdue.

Now, you talked about Glenn Tilton at United Airlines, but I have got a friend of mine in Detroit at Ford Motor Company, Alan Mullaley, who was paid—he just started—$28 million in the first 4 months of his job, from a company that has reported a $12.7 billion loss for last year and is reducing and relocating factories all across the country.

Ford, General Motors, Daimler-Chrysler prepare to start negotiations with the unions to obtain concessions and labor savings with the current contracts, how do they do that? Well, I will tell you. It is because section 1113 of the Bankruptcy Code allows the debtors to avoid contractual obligations under collective bargaining agreements with their workers.

People keep asking why is the UAW conceding so much to the corporations. Well, it is because the corporations tell them we are going into bankruptcy, we are going into court, and we have got the authority to eliminate contractual obligations.

How many lawyers would enter into an agreement and then one of them calls back the other in a year and says, well, things have gone sour, we have got to renegotiate, my friend. They would be asked if they lost their minds. But this is in bankruptcy law at this point.

And so it is time we try to deal with this. The gentleman from Massachusetts, Senator Kennedy, tried vainly to improve on it. I introduced legislation with Evan Bayh of Indiana just in the last Congress to try to at least make the executives report the amounts of money that they are receiving. This goes in under the radar screen.

And so this hearing couldn't have come at a more appropriate time. I commend the Members of the Subcommittee, but especially the Chairwoman.

Ms. SÁNCHEZ. Thank you for your statement, Mr. Conyers.

Without objection, other Members' opening statements will be included in the record.

And without objection, the Chair will be authorized to declare a recess of the hearing.

I am now pleased to introduce the panel of witnesses for today's hearing. Our first witness is Damon Silvers, associate general counsel for the AFL-CIO. Prior to his current role, Mr. Silvers was a law clerk for the Delaware Court of Chancellery for Chancellor William T. Allen and Vice Chancellor Bernard Balick. Mr. Silvers is also a member of the American Bar Association Subcommittee on International Corporate Governance.

Welcome.

Our second witness is Antoinette Muoneke. Ms. Muoneke has been a flight attendant for United Airlines since 1979. She resides in Federal Way, Washington.

Thank you for being here.

Our third witness is Mark Wintner, a partner at the law firm, Stroock and an expert on employee benefits law and executive compensation. Mr. Wintner chairs the American Bar Association Business Law Employee Benefit Subcommittee on Planned Termination, Merger and Bankruptcy. Mr. Wintner also serves as a member of the ABA's Joint Council on Employee Benefits.

Thank you for being here.

And our final witness is Richard Levin, vice chair of the National Bankruptcy Conference. Mr. Levin is a partner at Skadden Arps, concentrating on corporate restructuring and solvency and bankruptcy issues. Mr. Levin was counsel to a House Judiciary Committee Subcommittee and was one of the principal authors of the Bankruptcy Code and the Bankruptcy Reform Act of 1978.

We appreciate you being here this morning as well.

Without objection, your written statements in their entirety will be placed into the record and so we would ask that you limit your oral testimony to 5 minutes.

You will note that we have a lighting system that starts with a green light. At 4 minutes, it turns yellow. That is your warning that you have a minute to try to summarize your testimony. At 5 minutes, the light will turn red, notifying you that you are in fact out of time.

We will let you go a little bit over to let you complete your thoughts, but please try to be mindful of the time and the lights.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit.

Mr. Silvers, will you please proceed with your testimony?

TESTIMONY OF DAMON A. SILVERS, ASSOCIATE GENERAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, WASHINGTON, DC

Mr. SILVERS. Thank you, Madam Chairperson. My name is Damon Silvers. I am an associate general counsel of the American Federation of Labor and Congress of Industrial Organizations. I will try to be brief so that my client to my left can speak, who I think really has point of precedence here.

In 2002, the AFL-CIO helped over 5,000 laid off Enron workers, non-union workers, recover up to $13,500 in severance money that had been taken away from them in the bankruptcy process. During that time, the chief executive officer of Enron—this is after the departure of Ken Lay—during that time the chief executive officer was Steve Cooper, a principal in the turnaround group of Zolfo-Cooper.

Enron, of course, liquidated. It was one of those bad situations that Congressman Cannon was referring to. But when the case completed, Steve Cooper's firm received about $120 million in compensation for the work he did.

Mr. Cooper then went out and bought for himself a $20 million penthouse apartment on Fifth Avenue, perhaps the most expensive piece of apartment real estate purchased in New York to date.

Contrast Steve Cooper's fate with that of my friend Louis Allen, who was a mid-level executive at Enron. He was in charge of trans-

portation at Enron. Mr. Allen was a single father, the first person in his family to go to college and to work in management. Mr. Allen lost his job, his 401(k), his health insurance and his home and, with his 11-year-old daughter, had to return to living with his mother, who worked as a grocery clerk in Houston.

Louis Allen, in the end, got only a small fraction of the severance he was promised by Enron, and in the fall of 2002, still without a job and living with his mother and 11-year-old daughter, Mr. Allen had a stroke and died at the age of 44. Neither he nor his mother nor his daughter has, to date, received any meaningful recovery from his lost pension.

The AFL-CIO is extremely proud of the role that the working people of this country played in standing up for the Enron workers, but we do not believe that the outcome I just described, on the one hand for Mr. Cooper and on the other hand for Mr. Allen, could be described by any sane person as just. And in this respect, Enron was not the exception but the rule.

Let me give you a couple of examples from some more recent well-known bankruptcies. United Airlines: all United employees, including Ms. Muoneke to my left, lost their real pension plans and all the retirees had substantial cuts in their retiree health benefits. United flight attendants, who before the bankruptcy had incomes typically in the 30's—$30,000, not $30 million—took pay cuts of 17 percent.

I don't think most of us can possibly comprehend what it means to be living on a $30,000 a year income and take a 17 percent pay cut.

As you mentioned, Madam Chairwoman, the CEO got $39 million in stock and an $840,000 cash bonus.

Delphi Corporation: tens of thousands of jobs gone. Motions in front of the bankruptcy court to cut middle class wages to $12.50 an hour, and in parallel, motions in front of that court for close to $500 million in total executive comp, $40 million of which have been granted.

Dana Corp.: Congressman Cannon, I think, described in great detail what the executive comp package that was eventually approved was. For those of us who may be slow on the math, that is about $7 million a year in potential comp that was awarded by the court, following the Congress's attempt to rein these matters in, while simultaneously that same company is seeking to cut pay, to end programs, to end benefits for workers such as life insurance, long-and short-term disability, even tuition reimbursement. And to completely eliminate Dana's obligation to pay retiree health care benefits.

Like so much of our system of business regulation and corporate governance, our business bankruptcy system has become a vehicle for the transfer of evermore staggering amounts of wealth from a variety of parties, but in particular from long-term employees, into the hands of a very, very small number of executives and turnaround specialists.

As was discussed earlier, Madam Chairwoman, Congress has tried to rein in this intolerable trend by placing strict limitations on so-called retention bonuses in bankruptcy. Unfortunately and predictably, the corporate response has been to relabel the same

amount of money and keep paying it, and the courts appear to be going along with that maneuver.

The bankruptcy system has become a mere mirror of the excesses found in the larger corporate culture, but there are structural reasons why those excesses are particularly harmful in bankruptcy. Those structural reasons—and I will try to wind up here—those structural reasons, the central aspect of them is the fact that bankruptcy is an environment in which all contracts are potentially breachable. And so the typical rationale for focusing executive behavior on one particular constituency, the equity of the company, does not apply in bankruptcy.

And the further harmful aspect of this is the incentive effect on executives who are contemplating from the perspective of a company not yet bankrupt, who are contemplating going into bankruptcy and declaring a war of choice against their employees and their communities.

In response, the AFL-CIO believes the Congress should take two steps to address these problems with executive pay. First, the sorts of procedural protections that Congress recently put in place with respect to KERP's should be brought in to cover executive pay in its totality so that the sort of game-playing that Congressman Cannon alluded to cannot take place.

Secondly, Congress should mandate that pre-petition executives, executives who have not filed yet, who are seeking to breach contractual commitments to their employees should have to personally share the pain in an amount proportional to what they are asking their colleagues to bear. Such a measure would focus the minds of executives contemplating bankruptcies, as I have said, as a war of choice, before they made any decisions that the rest of us might come to regret.

The AFL-CIO looks forward to further hearings and I thank you for your time.

[The prepared statement of Mr. Silvers follows:]

PREPARED STATEMENT OF DAMON A. SILVERS

Good morning, Chairwoman Sánchez, my name is Damon Silvers and I am an Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations. First, let me express the labor movement's gratitude to you and the Committee for holding this hearing on the enormously important question of whether executive compensation in our business bankruptcy system is fulfilling the overall purposes of the bankruptcy code.

In 2002, the AFL-CIO assisted over 5,000 laid off non-union Enron workers in their efforts to obtain the severance payments they needed to live on while they found new work. After months of litigation in the bankruptcy courts, we obtained a settlement which paid the workers up to $13,500 in lost severance pay. During that time the Chief Executive Officer of Enron was Steve Cooper, a principal in the turnaround firm of Zolfo Cooper. Enron of course liquidated, and when the case completed, Steve Cooper's firm asked from the court a $25 million "success fee," even though the Justice Department's U.S. Trustee Program uncovered unacceptable billing practices (Cooper eventually agreed to cut this fee in half). This was after Cooper and his firm were already paid $107 million for their work.[1] Cooper recently bought a $20 million penthouse on 5th Avenue, one of the most expensive apartments sold in Manhattan during the real estate boom.

Contrast Steve Cooper's fate with that of Louis Allen, a mid-level executive at Enron. Lewis was a single father, the first person in his family to go to college and work in management. He lost his job, his 401k, his health insurance and his home, and with his daughter had to return to living with his mother, who worked as a

[1] *The Houston Chronicle,* 3/28/2006.

grocery clerk in Houston. Lewis Allen in the end only got a fraction of the severance he was promised. In the fall of 2002, still without a job and living with his mother, Lewis had a stroke and died at the age of 44. Neither he nor his mother nor his daughter has to date received any meaningful recovery from his lost pension.

The AFL-CIO is extremely proud of the role the working people of this country played in standing up for the Enron workers. But we do not believe the outcomes I just described could be described by any sane person as just. And the outcome at Enron has much in common with the grotesque inequities workers experience throughout the business bankruptcy system today.

Let me give you a couple of examples from some well-known recent bankruptcies.

Polaroid—Upon filing for Chapter 11 in 2001, Polaroid reneged on its severance policies, and cut off all company payments for employees' health, dental and life insurance plans. Six months later, a bankruptcy judge approved Polaroid's plan to pay $4.5 million in retention bonuses to forty executives. The plan approved by the court provided for the most senior executives in the pool to receive bonuses of as much as 62.5% of their base pay as well as severance payments also equal to 62.5% of their base pay. Other executives would be eligible to receive bonuses and severance payments equaling 25 to 50% of their base salaries.[2]

United Airlines—United went into bankruptcy as a strategy to extract significant labor cost cuts. All United employees lost their defined benefit pension plans and retirees ended up with substantial cuts in their retiree health benefits. United employees took 15% to 40% pay cuts, including a 17% cut for flight attendants and 40% cut for pilots. In total, over 50,000 United employees gave up several billions of dollars. At the end of the case, United proposed emergence stock grants for management worth $150 million in its reorganization plan—about 9% of the new stock of the company. Last year pay and stock worth $39 million was awarded to United CEO Glenn Tilton, including an $840,000 bonus (over 120% of his base salary).

Delphi Corporation—Delphi, a large automotive supply company went into bankruptcy in 2005. Delphi immediately proposed to eliminating thousands of U.S-based jobs and cutting the middle class wages earned by people making sophisticated auto parts down to as little as $12.50 an hour. At the same time—mere weeks into its bankruptcy case—Delphi unveiled a Key Employee Compensation Program of six-month "bonus opportunities" and an emergence bonus plan consisting of $88 million for some 486 managers—some payments as much as 280% of salary. In addition, Delphi proposed to grant 10% of the reorganized Delphi's equity to 600 executives, a program valued at $400 million, including $12.5 million in restricted stock for its top five executives. Just prior to bankruptcy, Delphi enhanced its severance program for 21 executives—severance that would pay out between $30 million and $145 million. So far, Delphi has gotten approval of bonus plans worth about $40 million a year but the severance payments were not even subject to court oversight, nor was a signing bonus paid to Delphi's new CEO in lieu of salary, since they were in place before Delphi filed its case mere days before the new Bankruptcy Code amendments took effect.

Dana Corporation—Dana is another automotive parts supplier that filed a bankruptcy case in New York last year. Dana's restructuring plan is to send as many good-paying U.S. manufacturing and assembly jobs as it can to Mexico and other low cost economies. For the jobs that are left, Dana asked the bankruptcy court to cut pay, and cut or eliminate a wide range of benefits such as life insurance, long and short term disability—even tuition reimbursement programs, and completely eliminate Dana's obligation to pay retiree health benefits. Before they got to bankruptcy court on the workers' pay and benefits, though, Dana's senior executives renegotiated their employments contracts. Those contracts, which included significant stock-based compensation pre-bankruptcy, were not worth what the executives thought they'd be worth as a result of Dana's bankruptcy. Under their renegotiated contracts, Dana's CEO, between a base salary of $1 million per year plus bonuses, can earn $6.5 million a year while the company is in bankruptcy. The other five senior executives can earn combined annual compensation of $ 7 million while their company is in bankruptcy.

US Airways—US Airways went through two bankruptcy cases in which the pilots' pay alone was cut up to 50%. In addition, by the time the two cases were over, all the employees lost their pension plans and retiree health was all but eliminated. US Airways' management got a bonus and severance program worth some $20–30 million.

Workers in chapter 11 cases across a wide range of industries (manufacturing, airline, trucking, retail and other service industries), are paying an enormous price

[2] Jessi D. Herman, *Pay to Stay, Pay to Perform or Pay to Go?: Construing the Threshold Terms of 503 (C)(1) and (2),* EMORY BANKRUPTCY DEVELOPMENTS JOURNAL, Fall 2006, 319

under threats that their labor agreements will be rejected, their jobs will be outsourced and retirement security threatened. Meanwhile, company executives and management move quickly to secure their own agreements and replace compensation such as supplemental executive retirements plans and stock-based compensation rendered worthless by the bankruptcy payment priorities with new, lucrative programs that insulate them from the economic dislocation of the bankruptcy.

Like so much of our system of business regulation and corporate governance, our business bankruptcy system has become a vehicle for the transfer of ever more staggering amounts of wealth from a variety of parties, but in particular long term employees, into the hands of a very, very small number of executives and turnaround specialists. Recently, Congress tried to rein in this intolerable trend by placing strict limitations on so-called retention bonuses in bankruptcy.[3] In response, the management community and their compensation consultants, with the full cooperation of the bankruptcy bench, appear to have continued the same type of post-petition payments to pre-bankruptcy management under new labels—most prominently now as "incentive pay," where highly speculative incentive targets are designed to guarantee some payment, even for delivering a business plan or reorganization plan, something reorganization fiduciaries are required to do anyway.[4]

Runaway executive compensation in bankruptcy takes place in two contexts—the context of the general explosion in executive compensation in American business, and the second is the unique and not well-understood context of corporate governance in bankruptcy.

The bankruptcy system necessarily gives the debtor (aided by the bankruptcy courts) great latitude in crafting the path for businesses in Chapter 11 to return to financial health. Part of this approach is both explicitly by statute and even more so in practice for bankruptcy judges to grant substantial deference to both the immediate requests of the debtor in possession, and to give the debtor initial exclusivity in proposing a plan. These basic structures of the Code are absolutely necessary—but they left the courts ill-prepared to deal with the culture of CEO excess because what that culture is all about is the executives of the debtor in possession proposing a series of self-enriching transactions, usually with the support of a coterie of experts, again paid by the debtor in possession. The Lake Wobegon effect that has long been noted in executive compensation is particularly powerful in bankruptcy, where courts tend to apply a reasonableness test to applications for enormous post-petition executive pay packages based on the representations of one or more consultants that this package is within the third quartile for companies of this type.

The bankruptcy system has become a mere mirror of the excess found in the larger corporate culture. The dimensions of that excess have recently been explored by the House Financial Services Committee.[5] It is sufficient to point out here that Chief Executive Officer pay in 350 public companies with revenue in excess of $1 billion has risen by 300% in the last fifteen years, and that CEO pay is on average 411 times[6] that of the average worker, up from 107 times in 1990 and 42 times in 1980.[7]

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[3] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), 11 U.S.C. § 503(c)(1), provides that the debtor shall not make payments to insiders such as executives for the purpose of inducting such person to remain with the debtor's business without an express finding by the court that 1. The payment or obligation is essential to keep the person from accepting a bona fide job offer for the same or greater pay; 2. The person's continued retention is essential to the survival of the business; and 3. The amount of payment to made or obligation to be incurred does not exceed either 10 times the amounts paid to non-management employees in the same calendar year or 25 percent of the amounts paid to insiders in the calendar year preceding that in which the payment is to be made, as described by Yair Listoken, *Paying for Performance in Bankruptcy: Why CEOs Should be Compensated with Debt,* John M. Olin Center for Studies in Law, Economics, and Public Policy Research Paper No. 334, Yale Law School, p. 5, quoting Jason Brookner, *Law Limits Executive Compensation,* May/June EXECUTIVE LEGAL ADVISOR (2006).

[4] See In re Dana Corp., 351 B.R. 95 (Bankr. S.D.N.Y. 2006).

[5] Reference recent Barney Frank hearing transcript. *http://www.house.gov/apps/list/hearing/financialsvcs—dem/hr030607.shtml.* The AFL-CIO tracks executive pay trends in public companies on our Paywatch website, http://www.paywatch.org. An analysis of 2007 proxy data on executive pay was posted earlier this month.

[6] United for a Fair Economy/Institute for Policy Studies, "Executive Excess 2006". Total executive compensation data based on *Wall Street Journal* survey, 4/10/2006; all other years based on similar sample in *BusinessWeek* annual surveys of executive compensation, now discontinued. Average worker pay is based on U.S. Department of Labor, bureau of Labor Statistics, Employment, Hours, and Earnings from Current Employment Statistics Survey.

[7] *BusinessWeek,* 4/22/2002.

But runaway executive pay in bankruptcy is not just another example of this larger problem. There are structural reasons why when the excess and inequity that characterizes our corporate economy as a whole is moved to the bankruptcy setting it is both even less defensible and does significantly more harm.

Much modern thinking in corporate governance begins from the distinction between constituents of the corporation with fixed contractual claims (lenders, suppliers, customers and workers) and those with variable, and in particular marginal claims (equity holders). But in bankruptcy the one thing that is clear is that contractual claims to one degree or another are not going to be honored.

Secondly, the purpose of the Code is very clear—it is to preserve as much going concern value as possible, and in the process preserve the bankrupt firm for the explicit purpose of preserving both jobs and community economic structures. It is not to maximize the value of any given constituency of the firm—be that secured creditors, unsecured creditor, or most inappropriately, the pre-petition equity holders.

Thus the notion, always ultimately hard to defend in any context, that corporate executives should be working to maximize one constituent's value, is particularly inappropriate to bankruptcy law. And yet, as recent both journalism and academic articles make clear, debtors are increasingly organizing themselves around one dimensional measures of business success that easily allow for excessive executive compensation when those measures are achieved.[8]

This trend is a departure from the historic experience of distressed companies. Writing in 1994, Professors Stuart Gilson and Michael Vetsuypens found that one of the key forces ensuring accountability by incumbent management in a distressed company was the pressure from courts and creditors for executives to "share the pain."[9]

Congress should be most concerned about these dynamics when they involve management teams that have taken their companies into bankruptcy and then seek large compensation packages. Courts' indulgence of this pattern creates reasonable expectations on the part of company managements that they can use the bankruptcy process to wipe out the equity (to which they have a fiduciary duty) and renege on contractual commitments to the most vulnerable of the company's constituencies—long term employees and host communities—and they will be ensured of not only keeping their pre-petition compensation, they are likely to receive further lavish rewards in addition to the packages they began with.

The result is not only an imbalance in outcomes. These arrangements encourage bankruptcy processes that are dominated by an alliance of incumbent management with subgroups of creditors to the detriment often of the firm as a whole (see Gretchen Morgenson's April 15 New York Times report of a new study of asset sales in bankruptcy) and of the very people the Code was intended to protect. After all, if we just wanted liquidations for the benefit of the secured creditors, we wouldn't need a Bankruptcy Code in the first place.

The AFL-CIO believes that Congress in response to the destabilization of the traditional balance represented by the Code, should take two steps to address the problems with executive pay in bankruptcy. First, the sorts of procedural protections that Congress recently put in place with respect to KERPS should be broadened to cover executive pay in bankruptcy as a whole. Second, Congress should mandate that pre-petition executives seeking to breach contractual commitments to their employees should have to personally share the pain in an amount proportional to what they are asking their colleagues to bear. Such a measure would focus the minds of executives contemplating bankruptcy as a "war of choice" against their employees and their communities.

The AFL-CIO looks forward to further hearings as part of a larger examination of the fairness of the business bankruptcy process. Thank you.

Ms. SÁNCHEZ. Thank you for concluding.

Ms. Muoneke, will you please begin your testimony?

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[8] See for example, Gretchen Morgenson, "In Bankruptcy, 'For Sale' May Mean 'You Lose'" New York Times, April 15, 2007, Section 3, p. 1. Thus Listokin (see above) is correct to argue that executives of bankrupt entities should not have incentives aligned with equity holders. But he is wrong to suggest those incentives should be aligned with unsecured creditors in a similar fashion to the way many believe executive pay should be aligned with the outcomes of equity holders in solvent corporations. Whatever the merits of this sort of position with respect to solvent corporations that are honoring their contractual commitments, these arguments do not address the circumstances of an insolvent entity.

[9] *Creating Pay for Performance in Financially Troubled Companies,* JOURNAL OF APPLIED CORPORATION FINANCE, Winter 1994, 81–92.

TESTIMONY OF ANTOINETTE MUONEKE, ASSOCIATION OF FLIGHT ATTENDANTS—CWA, FEDERAL WAY, WA

Ms. MUONEKE. Thank you, Chairwoman Sánchez and Members of the Subcommittee for holding this hearing. My name is Antoinette Muoneke. I have been proud to work as a flight attendant for 28 years.

After graduating from college I chose my career with a union contract that included a defined benefit pension plan and a means to follow my dream of providing for a family along with my own future.

But today it sickens me that my chosen career makes me qualified to testify about the gross injustice taking place across corporate America with the blessings of the corporate bankruptcy laws. I will share my experiences, but I could easily point you to any of my colleagues. We are all facing the same uncertainties.

When one of my colleagues said that she wanted the CEO of our company to explain to her daughter why she had to cancel her dance lessons, my heart knew her pain, but it gave me the courage to come here to tell you my story today.

When I started my career, my union contract gave me the tools to have a secure future, but I knew I had to do my part. Saving and planning took on a more important role after the birth of my daughter. After a year of marriage, I found myself newly divorced and a single mother.

My time off was devoted to my daughter. Our apartment near Seattle was rented and I was saving to buy a small condo. We were far from rich, but we had what we needed for a good life together and security for tomorrow.

Life brings many challenges and in June of 2001 I was involved in a car accident that kept me off my job for a year. Health care expenses burned through my savings and I was forced to borrow against my 401(k), which at the time was only a supplemental source of retirement.

In that same year, the events of September 11 were devastating and dramatically changed my job. Little did I know executives would take advantage of the industry's downturn to drive executive wages up and their employee wages down. I cannot escape the conclusion that executives used the bankruptcy laws to enrich themselves at the expense of workers like me.

The cuts forced during bankruptcy have turned my life upside down. I worked full-time before, but now my hours away from home have increased by nearly 40 percent. My pay is now $5,000 less than it was prior to these long hours and additional days away from home. Higher medical costs have forced me to change my insurance to an HMO, which is fine while my daughter and I are healthy, but as I care for my mother, who has persistent health issues, I pray every day that I don't have to face a life-changing illness that an HMO wouldn't cover.

Perhaps the most devastating change is the end of my retirement security. Executives terminated my 1010, and even with the new retirement plan, over 30 percent of my pension is gone and because my 401(k) is now my only retirement, I have no additional savings.

I am still struggling to pay off my 401(k) loan and I have had to lower my 401 deferrals to 3 percent. That is the full amount that

is required for the company's matching contribution, but not nearly enough to build a secure retirement. I will never recover the lost value of my pension, a pension that I have worked a lifetime to build.

So, am I angry that my CEO has preserved his $4.5 million trust while he has destroyed my future security? Am I angry that executives have taken 40 percent or more in raises every year while I worry that my memory is going because I work such long hours? Am I angry that last year alone our CEO used the bankruptcy laws to take pay bonuses and stock equaling over 1,000 times my compensation? Am I angry that his bonus is 125 percent of his annual salary while I don't know what tomorrow will bring or if I will become a burden to my daughter?

Yes. The answer is yes, I am angry. And I am tired. I was devastated when my union reported on a court hearing about our objection to enormous stock and bonus packages management awarded to themselves. In essence, the judge shrugged his shoulders and he said there was nothing he could do about it because the law did not give him a standard to determine how much is too much.

I don't begrudge executives fair compensation, but explain to me this, Madam Chairperson. How is it that their pay can skyrocket while average workers like me have to suffer? If your answer to this is because the law allows it, then it is time to change the law.

[The prepared statement of Ms. Muoneke follows:]

PREPARED STATEMENT OF ANTOINETTE MUONEKE

Thank you, Chairwoman Sánchez, and members of the Subcommittee, for holding this hearing on the growing disparity of compensation between workers and executives. I especially want to thank you for providing me with the opportunity to testify today. I am honored and humbled to represent my co-workers and all of the workers who are enduring life-changing sacrifice due to pay, healthcare, work rule and pension cuts forced during Chapter 11 Bankruptcy. We made painful concessions that affected our families, threatened our children's opportunities, decreased our ability to afford healthcare and destroyed retirement security. While workers live paycheck-to-paycheck and worry about what tomorrow will bring, a select few are lining their pockets with our sacrifices. We made these sacrifices for the long-term viability of the companies we worked so hard to help build and hope will continue to succeed.

My name is Antoinette Muoneke, and I have been proud to work as a Flight Attendant for 28 years. After working my way through college, on a fluke I applied with United Airlines just to practice my interview skills shortly before graduating from the University of Washington. Just weeks later I was on a plane to Chicago to spend the summer training to be a Flight Attendant. After one year of flying a furlough gave way to work in advertising at Sears, which promised many opportunities for a good career. But when I was recalled to work at my airline, I chose instead to keep my career as a Flight Attendant. I enjoyed sharing work with colleagues who were well-educated and experienced professionals. And, I knew that recent Union negotiations had secured my retirement with a defined benefit pension plan. It was a thrill to meet different people every day, to contribute to a well-respected airline and to know that I would have the means to follow my dream of providing for a family along with my own future. Today, however, it sickens me that my chosen career makes me qualified to testify about the gross injustice taking place in the airline industry and across corporate America with the blessing of corporate bankruptcy laws.

Although I am certainly qualified to speak about this issue, I could easily point you to any one of my colleagues; we are all facing these same uncertainties. It is not easy to publicly display my private challenges, but I know that putting a face on the devastating circumstances families are forced to confront across our country is more powerful than any horrific statistics. Although I regret the need to testify, I hope that my personal story will help Congress root out this injustice that affects so many lives. For me, it was not an easy decision, but when one of my colleagues said that she just wanted our CEO to explain to her daughter why she had to cancel

her dance classes my heart knew her pain. If I can help shed light on this inequity with my story, then I have the courage to share my life with you today. That courage is strengthened when I think about helping to rebuild a world with opportunity for my beautiful daughter, Obia.

In my first days as a Flight Attendant my new life seemed extravagant compared with my time as a "starving student." Still, my college lifestyle taught me to be frugal and I began saving from the beginning of my career. My union contract gave me the tools to have a secure future, but I knew I had to do my part. Saving and planning took on even greater meaning when my daughter was born and within a year I was a single mother, newly divorced. Becoming a mother was a career changing event. I had to rethink my schedule and work hard to maximize my time at home. Thanks to help from my mother in Obia's first years and generous assistance from a neighbor at a fraction of normal childcare costs, I was able to ensure my daughter had constant care and we lived a modest, but comfortable life. Our apartment near Seattle was rented, but I was steadily saving to buy a small condo in the same area and close to a good school.

My time off was devoted to my daughter, and I stayed close to her as much as I could by volunteering or organizing charity events at her school. Giving back to my community is important to me and I wanted to share that with my daughter. We routinely volunteered to help the homeless by handing out sandwiches and blankets in downtown Seattle or serving in soup kitchens on the holidays. I have always been proud that I have been able to provide the tools for my daughter to excel based on her own developed talents. I made sure that she could attend a good school where she could be a good student, take part in athletics, music and drama. We were far from rich, but we had what we needed for a good life together and security for tomorrow.

Life brings many challenges, and in June of 2001 I was in a car accident that kept me off the job for a year. I used vacation and sick leave to keep a paycheck coming, but healthcare expenses burned through my savings and caused me to borrow from my 401(k). At the time, borrowing from my 401k did not jeopardize my future when my primary source of retirement security was my pension plan. Before executives slashed my pay, benefits and pension, I could have bounced back from a personal setback like this.

In that same year, the events of September 11th were devastating and dramatically changed the responsibilities of my job. Little did I know, executives were at the same time taking advantage of the industry downturn and the bankruptcy laws to drive executive wages up and worker wages down to levels I hadn't seen since the early years of my career. I cannot escape the conclusion that those executives have exploited the economic downturn and the bankruptcy laws to enrich themselves at the expense of workers like me.

The cuts forced on workers during the bankruptcy have turned my life upside down. I worked full time before, but now my hours away from home have increased by nearly 40%. The airplanes are staffed with fewer of my colleagues even though nearly every passenger seat is filled and our safety and security duties have increased. We are forced to work longer hours, but even if I could cut back my time at work, I couldn't afford it. Working 40% more doesn't even make up for my loss in pay. I make about $5000 less than I did prior to these long hours and additional days away from home. While I have to find time to provide care for my mother who experiences persistent health issues, I cannot afford the good healthcare plan that we once had because the concessions forced by executives also included higher medical costs. I have had to change our insurance to an HMO, which is fine while my daughter and I are healthy—but as I care for my mother, I pray everyday that I don't have to face a life-changing illness that the HMO wouldn't cover.

I am desperate to insure that my daughter continues to have access to her good school, the Olympic development soccer program she's qualified for and her piano lessons. I know that the only way she will be accepted to college these days is to stand out as extraordinary. And, the only way to have a chance for a better life, the life we used to lead, is to get an education. Even so, the cost of college weighs heavy on my mind and we both hope for an athletic scholarship. But that means keeping up with her activities and paying for them. I have to juggle bills every month, worry about our rent and I am not always able to be at home to get her to practice or games. We have to depend upon other families to pick her up, and it kills me not to be able to reciprocate. I have had to stop my charity work due to time constraints, but this too causes an additional financial burden since her school increases tuition costs when charitable quotas are not met.

Perhaps the most devastating change is the end of my retirement security. With my pension plan terminated less than two years before I could qualify for retirement, my accrued defined benefit is subject to heavy penalties when paid by the

Pension Benefit Guarantee Corporation. Even with the new retirement plan, over 30% of my pension benefit is gone. And because my 401k is now my only retirement, I don't have any additional savings. I am still struggling to pay off my 401k loan, and I've had to lower my 401k deferrals to just 3%. That's the full amount required for the company matching contribution, but not nearly enough to build a secure retirement. I will never be able to recover the lost value of my pension—a pension I worked a lifetime to build. A pension promised instead of increases to pay and other Contractual benefits. A pension that helped me choose this as my career.

So, am I angry my CEO was able to preserve his $4.5 million pension trust while he destroyed my future security? Am I angry that executives have taken 40% or more in raises every year while I worry that my memory is going because I work such long hours? Am I angry that last year alone our CEO used the bankruptcy laws to take pay, bonuses and stock equaling over 1000 times my compensation? Am I angry that his bonus is 125% of his annual salary while I don't know what tomorrow will bring or if I will be a burden to my daughter? Yes, I'm angry, and I'm tired.

I was devastated when my union reported what happened in court when we objected to the enormous stock and bonus packages management awarded to themselves. In essence, the judge acknowledged our concern, but shrugged his shoulders and said there was nothing he could do about it because the law did not give him the authority to second guess management compensation, or a standard by which to determine "how much is too much."

Airline executives were well paid before the bankruptcy and I don't begrudge them fair compensation. But explain to me this, Madame Chairperson, how is it that their pay can skyrocket while the average worker is made to suffer like this? If your answer is that it's because the law allows it, then it's time to change the law.

I want to thank you again for giving me the opportunity to testify today. I will answer any questions that you may have.

Ms. SÁNCHEZ. Thank you, Ms. Muoneke.

Ms. MUONEKE. I want to thank you for giving me this opportunity.

Ms. SÁNCHEZ. Thank you for your testimony. I know it has been a very difficult road for you to get here and to give your testimony, and we appreciate hearing from your perspective.

Mr. Wintner, please begin your testimony.

TESTIMONY OF MARK S. WINTNER, ESQUIRE, STROOCK & STROOCK & LAVAN LLP, NEW YORK, NY

Mr. WINTNER. Thank you, Madam Chairman and Members of this Subcommittee.

The issues regarding executive compensation are not limited to Chapter 11, as many of the Members and panelists have mentioned before. That exists both inside and outside of Chapter 11. However, to focus in on Chapter 11 compensation without looking at compensation as a whole, leaves Chapter 11 companies in distinct competitive disadvantage in terms of retaining or attracting key executives and key employees during the Chapter 11.

I am not here to defend or criticize the 503(c) restrictions that were put on retention payments and severance payments. As alluded to earlier, I do note that the new rules, particularly on retention payments, are so restrictive as to virtually have made them disappear and, as a result, somewhat predictably, as also noted, the focus has shifted on pay-to-stay plans, which are really no longer tolerable for insiders under the Chapter 11 rules to pay for performance or pay for value.

I submit that the continued validity and health of those programs are essential to many Chapter 11 reorganizations.

Incentive pay in Chapter 11 enables debtors to compete in the marketplace. That marketplace already, outside of Chapter 11, in-

cludes a typical package of salary, bonus, long-term incentive plans, equity, severance, change of control and other arrangements. Right now, a Chapter 11 company cannot offer all of those things.

To further cut back on the ability of a Chapter 11 company to compensate and incentivize its executives will only lead to exodus of executives. I am not going to pretend that every executive is going to leave in that circumstance. Some will and some won't. But it becomes increasingly difficult to replace executives.

If you have good executives and they stay and they are under-compensated, you are lucky. If you have good executives and they don't stay because they are under-compensated—and under-compensated, I am not addressing the broader issue of what executive compensation should be to rank and file compensation in the universe of the marketplace, just why Chapter 11 companies cannot be put at a negative disadvantage to the rest of the marketplace.

If you want to replace management because they are not doing a good job and are trying to attract somebody and you cannot fairly compensate them, you are effectively asking them to leave a marketplace where they are not restricted to enter a marketplace where they are restricted in the context of a company which may or may not have a long-term future. That is very hard to do, virtually impossible.

Now, the courts have developed since the advent of the 2005 restrictions the emphasis on incentive pay instead of retention pay. Although we are still in the infancy of it, we are about 18 months in, it is working tolerably well. Executives are receiving lower packages than they did pre the 2005 reform amendments and some of the—in fact I think almost all the cases alluded to today predated the advent of those 2005 amendments.

The courts that have addressed it have addressed it under a business judgment rule, which is not an automatic stamp. There are several factors that need to be passed before the bankruptcy court will approve it.

I think it is not coincidental that in addition to the changes made between Dana 1, where the bankruptcy court in New York rejected the package as being too much like a retention plan and not enough like an incentive plan, and the approval 4 months later of the revised program, which was revised in many respects but equally significant, the Official Creditor Committee, the Ad Hoc Bond Holders Committee and other significant parties to Dana all opposed management in the consideration of the Dana 1 proposal and the court ruled against it.

The creditor bodies, at least, although not the labor organizations, supported the revised program for Dana 2 and it was approved. It was approved, therefore, with at least the input and the active participation and negotiation by other parties to the bankruptcy.

Nobody feels good about lost jobs, but nobody has demonstrated that capping compensation for executives is going to preserve those jobs. To the extent it simply leads more companies into liquidation or more likely into asset sales so as to get themselves out of both the restrictions of Chapter 11 as well as the relentless marketplace pressure on those troubled companies, that is not going to be good for anybody.

Thank you, Madam Chair.
[The prepared statement of Mr. Wintner follows:]

PREPARED STATEMENT OF MARK S. WINTNER

By way of background, I am a partner in the law firm of Stroock & Stroock & Lavan LLP and head of the Firm's ERISA and Employee Benefits Group. I have specialized for over three decades on a broad range of employee benefit and compensation issues, and have worked extensively on the employee benefit and compensation aspects of bankruptcy and reorganization proceedings. Specifically, I have been involved in advising debtors, official creditor committees, ad hoc bondholders committees and individual and groups of creditors, investors and purchasers on benefits and/or compensation matters in numerous Chapter 11 reorganization proceedings, including *Delta Airlines, Brooklyn Hospital, Dana Corp., Loral Space & Communications, Anchor Glass, Columbia Gas, Piper Aircraft, LTV Steel, Pan Am, Federated Department Stores, Wheeling-Pittsburgh, Coleco, Flushing Hospital, Raytech* and *W.R.Grace.*

I also lecture frequently on employee benefit and compensation matters in bankruptcy and have been a speaker for the American Bar Association (ABA), Practicing Law Institute (PLI), ALI-ABA and the Society of Actuaries, among others. I am a member of the American College of Employee Benefits Counsel and the ABA Joint Council of Employee Benefits.

The views stated herein are solely those of the author, and do not necessarily reflect the views of my Firm or any of its partners or of any Firm clients, past or present.

The very title of the hearing, "Executive Compensation in Chapter 11 Bankruptcy Cases: How Much is Too Much," suggests that there may be an objective standard which would enable bankruptcy courts and interested parties in Chapter 11 cases to discern when executive compensation crosses the line from "enough" to "too much." In my opinion, there is no feasible way of making such a judgment and, moreover, if there were it would vary from company to company, would not apply uniformly to different executives within the same company and would certainly change over time.

As the Subcommittee is aware, the subject of executive compensation in Chapter 11 cases was addressed by Congress just two years ago, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (the "Bankruptcy Reform Act"). The Bankruptcy Reform Act added Section 503(c) to the Bankruptcy Code, effective for Chapter 11 cases filed on or after October 17, 2005. Section 503(c) acts as a limitation on the authority conferred under Section 503(b) to allow administrative expenses of the Chapter 11 debtor's estate. Section 503(c) directs that even if a claim for compensation would otherwise satisfy the 503(b) requirements for administrative expenses, the claim will not be allowed (by the Bankruptcy Court) nor paid (by the debtor) if it falls into any of the three paragraphs of subsection (c), summarized below:

(1) covers retention compensation to be paid to an insider of the debtor, such as the debtor's directors, officers or other persons in control of the debtor, unless the bankruptcy court makes a finding based on the record that such payment is (i) essential to retaining the insider because the person has a bona fide job offer from another business at the same or greater rate of compensation and (ii) the services provided by the person are essential to the survival of the business. In addition, the court may only approve retention compensation programs that are capped at no greater than ten times the amount of similar payments provided to non-management employees, or if no such similar payments were made, no more than 25% of the amount of any similar payments made to such insider for any purpose during the year prior to the year in which such payment is to be made;

(2) covers severance to be paid 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 does not exceed ten times the amount of the mean severance pay given to non-management employees during the calendar year in which the severance payment to the insider is made;

(3) covers post-petition transfers or obligations incurred for the benefit of officers, managers or consultants, if such transfers or obligations are outside the ordinary course of business and not justified by the facts and circumstances. This provision would apply to incentive compensation and bonus plans.

The focus of this statement is on the type of compensation programs commonly referred to as key employee retention plans, or KERPs, and in particular, performance based KERPs. Prior to the enactment of the Bankruptcy Reform Act, KERPs had been used to provide certain high-level employees of a debtor with compensation

to induce them to stay with a debtor throughout a reorganization, in addition to the employee's base salary. These programs covered a wide range of benefits from severance pay to retention arrangements to success bonuses. They may have been structured to pay out if an employee remained employed through a particular date or event (sometimes referred to as a "stay bonus"), upon the occurrence of reaching certain business targets, or if the company terminated the employee. Historically, a debtor would use a KERP for employees that it considered integral to the operation (and if applicable, the reorganization or wind-down) of the company, and that it felt were necessary to retain during the uncertain times of the reorganization, much like a company outside of reorganization would use an incentive program to retain employees during uncertain times such as a downsizing or merger. Before the Bankruptcy Reform Act, bankruptcy courts applied the business judgment rule to the proposed KERP (i.e., the court would typically approve a KERP if it was persuaded that the debtor used sound business judgment, there was a legitimate business justification and the compensation program was fair and reasonable).

As discussed above, Section 503(c) of the Bankruptcy Code severely limits the amount of retention compensation and severance which can be paid to the debtor's insiders. In effect, the limitations on retention (or stay) payments and on severance as set forth in Section 503(c)(1) and (2), respectively, have already answered the question as to how much is too much for those types of payments. However, KERPs which are performance driven can still be reconciled with the new law.

Since Section 503(c) became effective less than two years ago, the decisions (published and unpublished) analyzing and applying the Section 503(c) restrictions are limited, however, even with this limited case law, it is beginning to come clear how courts have viewed the changes to the Bankruptcy Code. The case law has focused on whether the proposed plan is a "pay to stay" compensation plan, primarily used to retain employees and thereby subject to the limits of Section 503(c), or a "pay for value" compensation plan, primarily used as an incentive for employees to reach certain goals and a reward upon attainment of those goals and, therefore, subject to the standards of the business judgment rule.

One of the first cases to discuss Section 503(c) was *In re Nobex Corp.,* No. 05–20050, 2006 Bankr. LEXIS 417 (Bankr. D. Del. Jan. 19, 2006). In that case, the debtor sought to pay its chairman (acting as its chief executive officer) and its vice president of finance and administration incentive bonuses in addition to their regular compensation. The incentive bonuses were to be paid only in the event of a sale of the debtor and only if the sale price exceeded a certain threshold. The debtor argued that the chairman and vice president were necessary for a successful sale of the company and that they were committed to their employment even if no incentive compensation was paid. The court found that the plan was not an inducement for the chairman and vice president to stay with the debtor, but rather an inducement to increase the price received by the debtor in a sale, which would ultimately result in a greater recovery for creditors. The plan was approved by the court using the business judgment standard, not the Section 503(c) standard.

In the case of *In re Calpine Corp.,* No. 05–60200, the court approved a compensation program that included four different types of incentive payments. The program provided for payment of (i) bonuses upon the debtor's emergence from Chapter 11, (ii) bonuses based on the debtor's achievement of certain performance goals established by the debtor in consultation with various creditor constituencies, (iii) a supplemental bonus to non-insiders who performed a critical function at the debtor and were at significant risk of being hired by another company and (iv) a discretionary bonus to non-insiders. The court approved the latter two components of the compensation program outside of Section 503(c) because the payments were to non-insiders. The court also held that the emergence bonus and performance bonus were outside of Section 503(c) because they were incentive plans not retention plans.

In *In re Dana Corp.,* 351 B.R. 96 (Bankr. S.D.N.Y. 2006), the court rejected the debtor's proposed compensation program for senior officers. Notably, this was the same court that approved the Calpine program months earlier. The Dana compensation program, as initially presented, included a completion bonus that paid out on the debtor's emergence from bankruptcy, without regard to the actual performance of the company. The court held that since nothing was required of the employees other than remaining with the company through emergence, and it did not meet the requirements of Section 503(c), it was an invalid retention program. As Judge Lifland stated in the Dana opinion, "If it walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP)." Dana subsequently revised its program to include performance criteria and sought approval of the revised plan. With these significant changes, the court approved the program.

In the recent decision of *In re Global Home Products, LLC,* 2007 Bankr. LEXIS 758 (Bankr. D. Del. March 6, 2007), the debtor sought approval of a management

incentive plan which would award certain eligible employees a bonus equal to a percentage of base salary on a quarterly basis if minimum EBITDAR (Earnings Before Interest, Taxes, Depreciation and Rent) and/or cash flow objectives were achieved. The management plan was very similar to prior year incentive plans. The court analyzed and approved the plan outside of Section 503(c), holding that the plan was intended to incentivize management, not retain them. As part of its analysis, the court considered that in the prior year, under a similar plan, no bonuses were paid since the targets were not met.

Retaining or attracting key employees, directors or consultants is important for any company, whether in or out of Chapter 11, but Chapter 11 debtors have additional problems in this regard, most notably the inescapable fact that the future of the company is more uncertain than usual and that they cannot offer equity compensation during the reorganization proceeding. The Bankruptcy Reform Act has significantly curtailed the use of retention (or stay) bonuses and severance as meaningful incentives. Therefore, in addition to market competitive salaries and annual bonuses, performance based KERPS are the most significant means for a debtor to compensate insiders and remain competitive with other prospective employers. The ability to do so is not only important to debtors and insiders themselves, but to the creditors and other interested parties whose recoveries depend upon maximizing the value of the debtors.

The early experience with Section 503(c) is that the bankruptcy courts, after taking into account the view of the various creditor constituencies and other interested parties, are developing a workable set of rules which will enable insiders to be compensated on a competitive basis, but only if their performance has been beneficial to the estate. There is no need to impose limits on that process, particularly so soon after the Bankruptcy Reform Act. Any attempt to impose a one-size fits all absolute dollar or percentage limit on "pay for value" KERPs will frustrate the ability of the interested parties to design incentive compensation suitable for the particular needs of the debtor and be detrimental to the Chapter 11 process.

Ms. SÁNCHEZ. Thank you, Mr. Wintner.

Mr. Levin, will you please begin your testimony?

TESTIMONY OF RICHARD LEVIN, ESQUIRE, NATIONAL BANKRUPTCY CONFERENCE, NEW YORK, NY

Mr. LEVIN. Thank you, Madam Chair, and thank you also, and the Members of the Subcommittee, for inviting the National Bankruptcy Conference to be heard on this very important issue in Chapter 11.

As I note in my prepared testimony, I am here on behalf of the Conference, not on behalf of my law firm or any clients, and I am speaking only on behalf of the Conference.

This is a difficult and painful topic, as Ms. Muoneke's testimony so eloquently stated. Bankruptcy results in loss to many, and yet it is important that bankruptcy policy do whatever it can to enhance the value of what is there, whether through reorganization or through a liquidation proceeding, and it is important that people be there to carry out their duties to enhance the value of the company, so that what is left will be greater than if everybody just walks away.

There is most definitely a fairness element in determining executive compensation in bankruptcy that has to be balanced against the need to secure the services of executives and middle-level and senior managers to run a company while it is in bankruptcy or to run the liquidation. But the fairness element cannot be served by going too far in either direction, by permitting everything or by prohibiting everything.

Section 503(c), enacted 2 years ago, in fact almost exactly 2 years to the day ago, made an attempt at restoring some balance to an

executive compensation system in bankruptcy that had been subject to very great abuses. Nobody can question that.

It has its problems in the way it was drafted and implemented. It is a very difficult and unworkable provision. But it has served an important purpose in sensitizing the Bar and more importantly the Bench to the issues surrounding executive compensation and to providing some appropriate restrictions, although in our view we think perhaps the restrictions are more than are necessary to create this balance.

From our perspective, we look at bankruptcy policy and what is important in bankruptcy policy. We think bankruptcy policy is designed to preserve value and to promote fairness among constituencies that must make sacrifices, and with that we have four principles that we would state to govern any executive compensation legislation.

First, each case is unique. You cannot have a one-size-fits-all solution for all of the varied kinds of companies in reorganization. Second, consistent with the overall purpose of the bankruptcy laws, negotiation is the way to resolve these issues. And there should be adequate time given to the parties to negotiate resolutions. Neither side should be able to impose its will.

And, finally, we think basic fairness can be best promoted by focusing on the compensation of what we will call "senior management," or senior executives rather than mid-level management, who usually—and the difference here is that senior executives tend to have the opportunity to have much more influence and almost set their own compensation, whereas below the top level, that is less true.

And based on those principles, we would make two general recommendations. The first is that there should be procedural rather than substantive limitations imposed in the area of executive compensation. Substantive limitations that are too rigid will defeat the purpose, because they will violate the one-size-fits-all policy. Every case is unique. But procedural limitations will give parties time to get to the bargaining table and negotiate appropriate compensation arrangements to keep the people needed to preserve value and yet not let it go too far and give everybody time to be heard before the court.

And second, we would propose that 503(c) or any future amendment of it be limited to the senior executives as the SEC defines that term for proxy reporting purposes. They are really the five most highly compensated executives who have an executive role. It doesn't encompass the star performer who is not an executive who needs to be paid to perform and achieve value.

We think that would loosen the restrictions on people like Mr. Allen in Enron, that Mr. Silvers has discussed, and still focus on the top. All of the discussion this morning has been on the one or two people at the top, and that is where we think the SEC has got it right, and we would suggest that that be carried over into the bankruptcy area as well.

Thank you, Madam Chairman. I am ready to answer any questions.

[The prepared statement of Mr. Levin follows:]

PREPARED STATEMENT OF RICHARD LEVIN [1]

The National Bankruptcy Conference appreciates the opportunity to participate in these oversight hearings on executive compensation in chapter 11 cases and thanks the Subcommittee for its invitation. The topic is important to the administration of chapter 11 cases and preservation of jobs and value for all constituencies and equally important to maintaining fairness in reorganization. We commend the Subcommittee for focusing on this issue in its review of the 2005 bankruptcy amendments.

The Conference is a voluntary, non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws. Attached to this statement is a Fact Sheet about the Conference, including a list of its Conferees. Also attached is a Background Report on Executive Compensation Issues that was prepared by the Conference's Employee Benefits and Compensation Committee (the "Background Report").

Executive compensation has occupied headlines recently, and not just in bankruptcy cases. See Background Report, at [28–32]; "Transparency: Lost in the Fog," *New York Times,* Apr. 8, 2007, at BU1. In chapter 11 cases, the principal focus has been on retention, severance and incentive plans, especially since the 2005 addition to the Bankruptcy Code of section 503(c). This section, which was added by section 331 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,[2] imposes restrictions on the ability of a chapter 11 trustee or debtor in possession to implement retention, severance, or incentive compensation plans for its "insiders." [3]

To start, a definition of terms might be helpful to an understanding of the issues that section 503(c) presents. In common parlance, *retention plans* usually involve payments to employees who stay with the company for defined periods of time, even if their employment is not terminated. Retention plans are designed to give employees an incentive not to seek employment at another firm even though they may not be threatened with imminent loss of their jobs. Another job at a healthy company, even at reduced compensation, might seem more attractive than remaining with a chapter 11 debtor in possession, where employees face the stress and difficulty of operating a company in chapter 11 and the ultimate risk of being fired due to a reduction in the company's labor force or even liquidation of the enterprise.

A *severance plan* involves payments to employees upon the company's termination of their employment to cushion the impact of losing their job and to provide them time to seek alternative employment. In the bankruptcy environment, where, for many employees, the prospect of termination is on the immediate horizon, severance plans also serve the goal of retention by discouraging employees from seeking to leave the company in advance of being laid off. A severance plan is particularly appropriate where employees know they will be "working themselves out of their jobs," for example, by overseeing a liquidation or sale of the company. The better the employees perform in the liquidation or sale process, the faster they lose their jobs. All constituencies benefit from a swifter conclusion to the process. Retention and severance plans thus serve a common purpose in chapter 11 cases—keeping employees from seeking other employment for as long as the debtor company needs them.

An *incentive plan,* by contrast, is designed to motivate employees to achieve financial or other performance targets. The targets might be ordinary operating performance targets or targets relating to the reorganization or liquidation of the company. Although the incentive compensation will not be paid if the employee leaves the company before the relevant performance target has been met (which discourages

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[1] Partner, Corporate Restructuring Department, Skadden, Arps, Slate, Meagher & Flom LLP, New York, NY. The views expressed in this testimony are expressed solely on behalf of the National Bankruptcy Conference and do not necessarily represent the views of Mr. Levin, Skadden, Arps, or any of its clients.

[2] Pub. L. 109–8, § 331, 119 Stat. 23, 102, (2005).

[3] "The term 'insider' includes—

. . .

(B) if the debtor is a corporation—
(i) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;
(iv) partnership in which the debtor is a general partner;
(v) general partner of the debtor; or
(vi) relative of a general partner, director, officer, or person in control of the debtor;".

11 U.S.C. § 101(31).

the employees from leaving), an incentive plan's primary purpose is enhanced performance, not retention.

Incentive and severance plans are common among companies not in financial distress and often are required for a company to provide competitive compensation for middle and senior managers. *See In re Pliant Corp.,* Case No. 06–10001 (MFW) (Bankr. D. Del. Mar. 14, 2006) (prepetition incentive plan). Retention plans, though less common in the non-distress context, are also sometimes seen.

Properly designed, all three kinds of plans can enhance the viability and value of a business, and can serve a proper purpose in business in general and in reorganization cases in particular. *See In re AirWay Indus., Inc.,* 2006 WL 3056764 (Bankr. W.D. Pa. Oct. 3, 2006) (secured creditor underwrote incentive plan out of its own collateral proceeds to motivate employees to produce better recoveries). In chapter 11 cases, properly designed plans can be in everyone's interest because they preserve the business and jobs, and, ultimately, enhance creditor recoveries.

The difficulty, however, lies in ensuring that such plans are used in an appropriate way and are not excessive in light of their legitimate purposes. There is an obvious risk that such plans will be designed by managers to enhance their own compensation and will be more generous than strictly necessary to preserve the value of the business. While this risk exists at a non-bankrupt company, in a bankruptcy company, where other employees are being terminated or being asked to make sacrifices and creditors are incurring significant losses, there is a heightened concern over both unfairness and corporate waste.

In view of this potential for abuse, the National Bankruptcy Conference believes that bankruptcy procedures should be designed so that retention, severance, and incentive plans in chapter 11 cases are tailored to their legitimate objectives—preserving the debtor's business and enhancing its value—but are not excessive. In designing such procedures, however, care must be taken not to sweep so broadly that appropriately tailored retention, severance and incentive plans are impossible to implement. If the standards for authorization of such plans are too rigid or impractical, the goals of reorganization, preservation of jobs and enhancement of value may be thwarted, or, perhaps worse, parties will have an incentive find creative ways of circumventing the rules to meet the economic needs of the business. The Conference believes an appropriate balance must be struck.

Section 503(c) ostensibly was designed to address the unfairness and waste issues by limiting overly generous "pay to stay" packages for the executives who themselves are setting the payments. However, in its current form the provision can be criticized on a number of grounds.

To start, the section imposes impractical requirements. It permits retention plans only on an employee-by-employee basis, because it requires a showing as to the unique circumstances of each employee that would be covered. It applies only when an employee already has "a bona fide job offer at the same or greater rate of compensation" and when the services of such employee are "essential to the survival of the business"—requirements that are unlikely ever to be met. If an employee sought out and received such a "bona fide job offer at the same or greater compensation," it is unlikely the employee would choose to await the outcome of a hearing on a retention plan before deciding to accept the other offer. The "bona fide job offer" requirement defeats the principal purpose of a retention program, which is to keep employees from seeking other employment in the first place. The "essential to survival" requirement is difficult to meet in a moderate sized to large company, because the loss of any given employee will seldom be a genuine threat to the company's ultimate survival. The loss of a key employee may hurt the company, and the loss of a large group of such persons may threaten the company's survival, but it will be almost impossible to show that retaining a single individual is "essential to survival of the business."

Even if these facts could be shown, the section takes a formulaic approach to what payments may be made. This "one size fits all" approach limits the ability of the debtor in possession to design a retention program that is responsive to the needs of its operations, employees and competitive environment so that the objectives of the program to retain key employees can be achieved.

The section is also overbroad compared to the principal problem it was intended to address—senior executives lining their own pockets while other employees suffer. It can be read essentially to restrict even legitimate and necessary retention and severance programs for mid-level managers who have no control or influence over their own compensation but who can often provide substantial value to a company in distress if they stay and do their jobs.

Finally, ambiguities in the provision generate distracting and destabilizing litigation at the delicate early stages of a chapter 11 case over the distinction between prohibited "retention" plans and permitted "incentive plans," as well as over who

is an "insider" covered by the section, and who is not. Such litigation highlights to employees the uncertainty of their status just when the company has an urgent need to calm its workforce due to the initial shock of the bankruptcy filing.

These and other effects of section 503(c) are described in greater detail in the Background Report submitted with this testimony and in the "Memorandum on the Impact of Section 503(c) of the Bankruptcy Code and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on Executive Compensation," adopted by the Executive Compensation Committee of the American College of Bankruptcy, which we understand has been submitted to the Subcommittee for inclusion in the record of this hearing.

Despite its flaws, however, there is no question that section 503(c) has served the salutary purpose of sensitizing courts, creditors, and U.S. trustees to the issues of inappropriate executive compensation packages and has properly shifted the compass toward a far more reasonable approach to the issue. The National Bankruptcy Conference would suggest, however, that in the interest of all participants in the reorganization process, especially the debtor in possession's non-management employees, a more nuanced and balanced approach to executive retention issues is needed—an approach that preserves the new law's salutary effects, but also takes into account other important chapter 11 policies, like preserving and maximizing the value of a reorganizing debtor's business.

Our reorganization laws are premised on the idea that the value of an enterprise as reorganized often will exceed its liquidation value. Reorganizing permits the company to improve its operations, enhance its value, preserve jobs, and reduce sacrifices that need to be made by all constituencies. As this Committee recognized in proposing chapter 11 30 years ago:

The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.[4]

The objective of maximizing the value of the enterprise is distinct from the question of how that value, once maximized, should be allocated among creditors, shareholders, employees, and other stakeholders. It is proper to ask whether the value of the enterprise is being equitably distributed, but it is self-defeating if the method of effecting an equitable distribution among the parties reduces the value that is available to distribute. Generally speaking, therefore, issues of equitable distribution should be resolved only after appropriate steps have been taken to preserve and maximize the value of the business. The Bankruptcy Code was designed to facilitate such maximization (for example by permitting sale of unproductive assets, assumption of beneficial contracts and rejection of burdensome ones) and to encourage negotiations over the equitable distribution issue, with ultimate recourse to the court if the distribution issue cannot be consensually resolved.[5]

Labor issues in general, and executive retention and severance plans in particular, pose difficulties in the chapter 11 context because they typically intermingle and often create a conflict between the equitable allocation of sacrifice among employees and other constituencies on the one hand and the objective of maximizing reorganization value on the other. The Conference believes, however, that these apparently conflicting objectives can in fact be reconciled in the case of executive retention, severance, and incentive plans if a somewhat different approach from the one taken in section 503(c) is adopted. In the view of the Conference, this approach should take into account several basic principles:

- First, the approach adopted should recognize that each case presents a unique combination of demands on management, employees, and creditors, and that a one-size-fits-all formula to address executive retention and severance is too constraining to accomplish the bankruptcy objectives of maximizing value of the debtor's business and preserving jobs.
- Second, the approach adopted should also recognize that, for the vast majority of employees—those who do not control decisions relating to their own compensation—appropriate retention, severance, and incentive plans are matters

[4] H. Rep. No. 595, 95th Cong. 1st Sess. 220 (1977); *see* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984) ("the policy of Chapter 11 is to permit successful rehabilitation of debtors"); United States v. Whiting Pools, Inc., 462 U.S. 198, 203, 103 S. Ct. 2309, 76 L. Ed. 2d 515 (1983) ("Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if sold for scrap.").

[5] *See* Richard Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative,* 39 Bus. L. 441 (1984).

that should be resolved by negotiation between the debtor in possession and the stakeholders in the case.

- Third, the approach adopted should assure relevant parties adequate time to familiarize themselves with the underlying facts and needs of the business and to negotiate and resolve the issues or put them before the bankruptcy court.
- Finally, the approach adopted should address the basic fairness issue: preventing a limited number of senior management decision makers to reward themselves by designing for themselves excessively generous retention and severance arrangements while other employees and creditors are being called upon to accept sacrifices.

The NBC suggests two principal changes from current law that would help implement these principles:

- First, procedural limitations should be imposed to prevent adoption of compensation plans for senior officers of the company at such an early stage in the case that the constituencies (including those representing hourly employees) are not yet ready to participate in the negotiation of reasonable and balanced solutions. Any proposed program for senior officers should be debated by the parties and considered by the bankruptcy court in broad daylight and only after all key constituencies have had the opportunity to scrutinize the program and express their views. A reasonable minimum notice period should be imposed to allow a creditors' committee to be formed and to provide the committee and other parties a fair opportunity for review of the proposed program, and, if agreement is not reached, for there to be a fair opportunity for the parties to be heard before the court.
- Second, limitations on retention, severance, and incentive plans like the ones in section 503(c) should be specifically targeted against those senior executives who are in a position to make self-serving compensation decisions, and a more traditional business judgment test, which focuses on preservation of the value of the business, should be applied to authorization of such plans with respect to other employees.

The reasons for this more targeted approach are straightforward. A large company may have dozens of officers, such as vice presidents, a treasurer, a controller, and assistant vice presidents and treasurers, elected to officer positions by the board, who might be considered "insiders" covered by the current limitations in section 503(c). The real risk, however, of over-reaching, over-compensation and abuse lies not with this larger group of employees, but rather with the senior executives who play a role in setting compensation, usually the chief executive officer and a few other top executives.

The SEC has addressed this risk in the non-distress context by requiring disclosure of compensation of the top five most highly compensated executive officers. See Item 402(a), SEC Regulation S-K. This group generally would not include, for example, the star sales manager, the key engineer, the plant manager or the like, who may technically be an "officer" or "insider" of the company but who has no role in setting compensation. Adoption of the SEC dividing line to determine whose compensation is subject to heightened scrutiny in a chapter 11 case would help to assure fairness and avoid abuse, while at the same time not placing at excessive risk the important bankruptcy objectives of preserving the business, enhancing its value and ultimately increasing the likelihood of a successful reorganization that will minimize the hardships to be borne by all parties.

Limiting the restrictions of section 503(c) to the senior executives in control of compensation decisions will permit debtors in possession, where necessary and appropriate, to offer the incentives necessary to keep key middle managers and star performers focused on their jobs, without generating expensive, time-consuming, and distracting litigation. The process would likely be self-regulating and self-limiting, because CEO's and other senior executives are unlikely to propose excessive compensation for mid-level officers or junior employees if they are prohibited from providing excessive compensation for themselves. Regulating the top of the compensation pyramid is the best way to assure that other employees are offered only what is genuinely necessary to retain their services in the interest of the business.

Once again, I would like to thank the Chair and the rest of the Subcommittee for inviting the National Bankruptcy Conference to testify in these important hearings. The Conference would be pleased to consider this issue further if the Subcommittee desires, and we would be prepared to formulate detailed drafting proposals if the Subcommittee would find that helpful.

ATTACHMENT

National Bankruptcy Conference

A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

History. The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005.

Current Members. Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

Policy Positions. The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

Technical and Advisory Services to Congress. To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

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Ms. SÁNCHEZ. I should also mention before we move on to a round of questions that Glenn Tilton, the chairman, president and chief executive officer of United Airlines, was invited to testify at this hearing today but declined to do so and I think that is really a shame because if he were able to be here he perhaps would have had testimony that could have been enlightening as to the equitable considerations that are warranting this hearing on executive compensation.

It has been suggested that I subpoena him. We try to do all things with restraint and voluntarily.

We are now going to proceed with a round of questions subject to the 5-minute rule. I just want to warn the witnesses that we each will have limited time, as you did, in which to ask questions, so if you could be brief and concise with your answers, that would be helpful. It would allow Members time to ask the questions that they want to ask of the various panel members.

I will begin the round of questioning starting with Mr. Silvers.

The Office of the United States Trustee is required to supervise the administration of Chapter 11 cases and object to compensation requests pursuant to section 330 of the Bankruptcy Code where appropriate. In your opinion, do you think that the United States Trustee could play a more active role in policing excessive compensation requests?

Mr. SILVERS. I will give you a very brief answer. Yes.

I think that this is an example of the sorts of procedural protections that Mr. Levin referred to. And I think it is one of many areas in which the message throughout our Government in recent years has been to indulge inequalities of wealth rather than to police them.

Ms. SÁNCHEZ. And if you can, can you please explain for me the difference between a retention bonus and incentive pay?

Mr. SILVERS. Well, as a business matter, right, there is a notion that a retention bonus is designed to keep you at your desk and incentive pay is designed to make you do certain things while you are sitting there. I think this is a distinction of limited merit, frankly.

I fully understand, I think the AFL-CIO fully understands, that the politics of 2005 in terms of moving legislation through, promoted this notion that what we care about is this type of pay rather than that type of pay. I think the concern here is one of amount, but more importantly the real concerns here are not this distinction, which can be completely gamed and has been and will be again.

The real issues are twofold. One is simply the question of fairness, of amounts, of what is happening to people. But the more important question is the question of what we are incentivizing executives to do. The current system is one in which if you were sitting at your desk as an executive with a company that is not bankrupt and you were thinking about bankruptcy as a strategy, as a strategy for reneging on long-term promises made to long-term employees, you can do so today in the relatively certain knowledge that you personally will not only not suffer as you will make others suffer, but that you will actually profit by doing that. And that is really the heart of what we see as the problem here.

Now, again, we think that the solutions lie more in what Mr. Levin was talking about, procedural devices of various kinds, than in absolute caps or bars, for the very reason Mr. Levin said, which is that absolute caps or bars are an impediment to successful reorganizations.

Ms. SÁNCHEZ. Thank you.

Speaking of Mr. Levin, nice segue, Mr. Levin, you suggested that limitations on compensation should be specifically targeted against those senior executives who are in a position to make self-serving compensation decisions.

How would you devise a solution to implement that suggestion?

Mr. LEVIN. Well, as I said, the SEC Rule SK, I think it is section 402 of that rule, lists the kinds of executives that we would contemplate covering, and those are people like the CEO, the executive vice president, COO. They have different titles in every company, but they are the executive decision-makers that are usually the most highly compensated.

You very often see in a company, the most highly compensated individual is a sales manager because he gets a commission on sales or she gets a commission on sales and does just a phenomenal job selling the company's product. You don't want to limit that person. But that person also has no ability to affect his own or her own compensation. The executive, being at the top of the pyramid, does, and that is where I think the effect should be focused.

I will complete my answer with that. Thank you.

Ms. SÁNCHEZ. Okay, thank you.

And I am going to have one further question for you. As one of the original drafters of the Bankruptcy Reform Act of 1978, was it Congress's intent that Chapter 11 provide a level playing field for the various constituencies involved in a case? And with respect to labor interests, do you think unions still have a level playing field for participating in Chapter 11 cases?

Mr. LEVIN. It was definitely intended that all parties be given negotiating tools and levers to be able to sit at the bargaining table. Everybody makes sacrifices in a Chapter 11. I say everybody. Suppliers who sell goods after Chapter 11 get paid in full for the goods they sell. They are not making sacrifices. They are benefiting by being able to continue to do business. But if you don't pay them, they won't ship. It is that easy.

But generally speaking, everybody is asked to make sacrifices, and there is intent to create a level playing field and some balance in the bargaining power. It never can be completely equal, but you try to create some balance.

If anybody has a veto and has a right to walk away from the table, there is no need to negotiate, because that person can dictate terms. And it is hard to say exactly where that balance is, and it keeps getting readjusted every few years, and we hope Congress will continue to maintain that balance, because that is what drives consensual and therefore successful reorganizations.

Ms. SÁNCHEZ. Thank you, Mr. Levin.

I would now like to recognize the Ranking Member of the Subcommittee, Mr. Cannon, for 5 minutes of questions.

Mr. CANNON. Thank you, Madam Chairman.

Congressman Keller has asked me to ask unanimous consent to submit for the record the proxy statement with a cover letter from Mark Anderson, who is, I think, the vice president for governmental affairs of United Airlines.

Ms. SÁNCHEZ. Without objection, so ordered.

[Note: The information referred to is not reprinted here but a copy has been retained in the official Committee hearing record.]

Mr. CANNON. I would like to thank you for this panel. This is a very thoughtful panel, and we appreciate the input on both sides of the aisle.

This is an initiative that Mr. Delahunt and I worked on in the past and one that we need to focus us on. I always find it interesting when Mr. Conyers and I are on the same panel. We often agree, which may surprise some folks, but interestingly, when you are philosophically clear it is a lot easier to agree, because then you can actually talk about what can be done as opposed to posturing.

And so I want to just thank Mr. Conyers for his kind words and for the fact that we are able to be here today and looking at some of the things that we can actually do about, what is problematic, and it is problematic for reasons that you have all said.

I think after hearing the panel and some of the questions that the Chairwlady has asked, there is actually some consensus on this. And after Mr. Levin's response and Mr. Silvers, your response, it seems to me that there is some consensus that if we have procedures, then the parties will be able to negotiate and solve problems as opposed to having rigid tests or other mandates.

Is that a fair conclusion, Mr. Silvers?

Mr. SILVERS. Yes, I think that is. I think that what our position is is that caps, for example, on pay here, is not probably a wise way to proceed. And that the distinction between incentive pay and retention pay has proven to be one that can be gamed.

Mr. CANNON. Right.

Mr. SILVERS. And so I think we agree there. I am not sure we agree on what the procedures should be, but——

Mr. CANNON. Right, but the point is that at least we want to have some flexibility there and that a process is going to produce a better result than a rigid conclusion.

Let me just say, Mr. Levin, I really appreciate your long history of work in this very difficult broader area and in this particular area as well.

But, you know, I travel from here to Utah. I have lots and lots of air miles. And I spend a lot of time talking to stewardesses about this problem, mostly with Delta, but as you spoke this morning, Ms. Muoneke, it occurred to me that I would be interested in knowing whether you would prefer, retrospectively, to have had instead of a defined benefit pension plan a defined contribution plan. Have you thought much about that?

Ms. MUONEKE. I think personally, and in talking to my fellow flying partners, that we would like to have a matching plan. It would be in our best interest.

We did have one previously, but that was nullified by United earlier in my career. I think the difference is that my 401(k) wasn't a plan that I had from the very beginning of my career. This is something that was offered to us as a supplement to our defined

benefit pension plan that we all thought we were going to have when we retired.

If I had the choice and had known a number of years ago that I was going to have to rely solely on my 401(k), I would have planned my retirement differently. I would have tried to maximize my funding into my 401(k) instead of now playing catch up, which is very difficult to do.

Mr. CANNON. Right. The problem here, and I feel very sensitive asking you the question, because you are not back at the beginning and you are stuck where you are right now.

In particular, you said that your hours were up 40 percent and your pay is off $5,000. Is that $5,000 for the whole amount of the extra time you are working, or is your net pay, regardless of how many hours, less than what you were making before?

Ms. MUONEKE. To understand how our hours are, it is not as in the general public. I, prior to 9/11 occuring, I was flying 75 hours a month. Now, 75 hours a month does not include my total time away from home. That is just actual in-air flying hours.

Now I am flying 100-plus hours per month, so that is quite more hours per month that I have to fly, just to try to keep myself on track to where I was prior to losing my pay and my pension. But with my hours being up to what it is now, that means that I am away from home a lot more. I don't have the time to spend with my daughter. I have to rely on outside help to get here to different places that I need her to go.

So it is just a difficult situation, not only for myself but my colleagues. We are all facing the same crisis.

Mr. CANNON. Thank you. I appreciate your willingness to be here today.

I see that my time has expired, Madam Chairman. I yield back.

Ms. SÁNCHEZ. Thank you, Mr. Cannon.

Now it gives me great pleasure to recognize Mr. Conyers for 5 minutes.

Mr. CONYERS. Thank you, Madam Chair.

I want to suggest to the Subommittee that I am trying to examine the ways that we lift up all of the problems of the witness that has testified here in her individual capacity. The fact of the matter is there are hundreds of thousands of people in her condition, and we need to get a record on this, whether it is from the lawyers that represent them, the consumer groups, additional groups coming in, but this story has to be a part of the record, not necessarily the record of the Subommittee but a record somewhere where we can repair to this.

We are not going to lift up one person's testimony and say oh, that is really bad. There are lots of people out there that are in that position, and I would like to invite Chris Cannon and some of us to examine ways in which we can compile these records.

The second thing, I wanted to extent my sympathies to Mr. Wintner, whose plea for considering the poor executive who is about to lose some compensation, may even lose his job, gosh. Millions of people are being downsized, thrown out of work, kicked around all over the place, and we have the responsibility, you do, to come to us and tell us, but wait a minute, we don't want you

guys to go too far in the Congress, but you have got to think about, this may worsen the plight of the corporation.

Never once do you tell us about the incompetent executives that brought the company to that position in the first place. What do you do about them? Well, nothing. They frequently benefit from their own inability to govern correctly.

And so I just want you to know that I am sympathetic about executives. Man, let us be fair here. We haven't talked about the difference between Government trustees and private trustees, because the Government trustees at the Department of Justice should sooner or later be a witness here, and I am hoping that they do. I am getting it from a lot of judges and private trustees, that they are all saying that the system is tying the hands of the judges and they don't have any choice.

I don't know what is happening here at this hearing. I know what I am hearing and being told and I know we are gong to have some more hearings about this so that we can get to this problem, but are the judges' hands tied? Something has got to go on the record today.

Now, if we have to take Mr. Silvers' warning, that we are going to get gamed again if we are not careful, I mean we will abolish the distinction and we will do some great legislatively-sounding great things, but it won't change the practices and procedures that have emanated from that 2005 changes of the 1978 Bankruptcy Code. Much of that has gone out of the window. We have got means tests now for consumers trying to go into bankruptcy. We have got single parents, and here is one, trying to raise a family by themselves, and they may end up in a personal bankruptcy of their own. Forget the companies and these executives.

So I see a great challenge and opportunity. That is why I am so proud of this Subcommittee on the Judiciary. We are going to take this thing apart, issue by issue, and organization by organization.

And now I would like Mr. Wintner to join with me in the sympathy for the other people that could be harmed in this process.

[BUZZER]

Mr. CONYERS. Go ahead.

Ms. SÁNCHEZ. I am going to request unanimous consent that the gentleman be given 1 additional minute of time so that the witness may respond.

Mr. WINTNER. Yes, thank you Congressman Conyers and Madam Chairman.

I actually represent various parties to Chapter 11s, in some cases debtors, in some cases creditors committees, in some cases individual creditors, in some cases ad hoc bond holders, and many other parties. Almost never, at least in a Chapter 11, do I represent the management in their capacity as management.

My creditor clients, and I am not speaking for anybody here but myself, but obviously it is based on my experience, they have no desire to overpay management. It is coming out of their recovery. Their only interest in terms of retaining or attracting management is simply one of self interest.

Mr. CONYERS. I know you are not kidding me, are you?

Mr. WINTNER. About which part?

Mr. CONYERS. About the part that they have—here we have examples before you of incredible, unjustifiable excesses, and the next thing you tell me after we have taken 5 minutes on this is to say they have no interest in giving undue compensation to the top executives.

Mr. WINTNER. They do not. And in fact, I would support the position stated by the other panelists as well as Members of the Subcommittee, that any procedural improvements which give all parties to the Chapter 11 a say in that executive compensation——

Mr. CONYERS. But what about the incompetent ones?

Ms. SÁNCHEZ. The time of the gentleman has expired.

If you would like, we can do a second round of questioning in which you will be allowed to continue with your question, Mr. Conyers.

At this time, I would like to recognize Mr. Franks for 5 minutes of questions.

Mr. FRANKS. Well, thank you, Madam Chair. And it is always interesting to come to the Committee.

Madam Chair, it appears to me that the challenge here sometimes is more basic than some of our examination here might indicate.

When we try to place at odds the executive of a company with the employees of a company, sometimes it becomes—we are focusing the entire effort, I think, on the wrong question. If our only concern were the employees of a company, if that were our only concern, and a company was having a challenge economically, would it not be in the company's best interest to try to use whatever market mechanisms necessary to bring in the very best possibility of preventing that company from failing entirely and being a complete loss, both economically, in terms of the job, and the potential benefits for retirement to those employees?

And I know that the challenge here for the courts and for us is to be able to separate that process, of trying to incent the greatest leadership for a company and what those compensation packages should look like, and those who would deliberately game the system and, like Mr. Silvers said, try to—that they would be literally incented to try to hurt the company and lead it into bankruptcy for some of their own financial reasons. That seems to be the challenge for me.

So I guess, Mr. Levin, if I could start with you, what are your key criticisms of the KERP's provisions? And if you could outline for us how the court's struggle with this dynamic. You know, they are trying to maintain a market-driven system here. I mean, the Soviets didn't have that. Everybody got paid the same, and it didn't work too well. So they want to try to maintain the market system here, and yet they want to keep people from gaming the system. How do they come up with that balance?

Mr. LEVIN. How do the courts come up with that balance?

Mr. FRANKS. What issues do you think are the key ones that the courts struggle with?

Mr. LEVIN. I think what we have seen in the practice under section 503(c) since it was enacted is that where there is broad agreement among the constituencies in the case, on what the executive compensation should be, the courts generally approve the agree-

ment. And when there is not agreement, the courts generally do not.

There is nothing in the law that says that is how it is supposed to work, but on the ground, I think if you look at the background report that the National Bankruptcy Conference submitted with our testimony here, I think you can trace through those cases and see that that is in fact what happens.

And I think that is consistent with the level playing field, Chapter-11-is-an-invitation-to-a-negotiation concept that Congress built into the process 30 years ago. I think that is what is going on.

In terms of the actual problems, one of the problems that I mention is that 503(c) sweeps too broadly. It sweeps too far down into the organization with key performers, important people, as I mentioned, people such as Mr. Allen, that Mr. Silvers mentioned, where there are no abuses, there have been no abuses. And that would be one change that we recommend.

And the other is to impose the procedures and the measured process that allows people to get to the negotiating table and get agreements.

Mr. FRANKS. Well, Mr. Levin, let me try to expand on that just a little.

Just a hypothetical situation. If you have got a company, a large, say, airline company, that has through incompetent leadership come to the point where they are in dire trouble, and you are only concerned about maintaining the company for the sake of the employees, what impediments are reasonable to say to that company, well, there are only a few people out there that can turn this around, and that is a highly competitive market out there for these people, but we are going to say to you that you can't hire them except under these conditions.

What impediments are reasonable? Shouldn't we pull out all stops to save the company?

Mr. LEVIN. Again, as I said earlier, pulling out all stops runs the risk of allowing one constituency to dictate the outcome. The other constituencies who participate in the negotiation process understand what you just said, that you need good people to try to save the business. And that you don't attract new management, assuming you had bad management, you want new management, you don't attract new management by paying way under-market.

So there is a balance. We hope that by attracting new people it will increase the overall value of the company and, therefore, diminish the pain that has to be shared among the various constituencies. But I don't think you can do that with a one-size-fits-all rule. It has got to be people understanding what their interests are, whether it is creditors or employees, understanding that new people, new management, can improve the situation, and that ought to be pursued without excess.

But define excess. It is, "how high is the sky?" You can't define excess in general. It has to be case specific.

Mr. FRANKS. Thank you, Mr. Levin.

Thank you, Madam Chair.

Ms. SÁNCHEZ. The time of the gentleman has expired. Thank you.

I would like to recognize at this time Mr. Johnson for 5 minutes.

Mr. JOHNSON. Thank you, Madam Chair.

Now, no doubt that there have been numerous documented instances of corporations that have been mismanaged by high paid, excessively, obscenely paid, executives, and then that corporation may find itself in bankruptcy, where the issue becomes whether or not there will be a liquidation or whether or not there will be a reorganization.

And, of course, when there is a liquidation, it means there is a cessation of the operations of the business, the creditors lose, the workers los, anybody who has ongoing relationships with the business loses. And then if there is a reorganization proposed, then there is a chance for the business to remain viable and perhaps be able to pay back either all or a percentage of its creditors and, of course, be able to pay its employees as it continues to operate.

Certainly a reorganization is probably better for all concerned, including the workers, than a liquidation. And in the case of a reorganization, then the issue becomes how much do you pay the executives to run the company and try to get it out of Chapter 11 and back to viability. And so executive compensation, how much do we pay the executives to lead the company out of bankruptcy, and I believe that that is one of the issues that we are here to address today.

And I have heard some comments, that we should have some limitations on compensation, and I have also heard that caps are not a solution. So if I could hear from each one of you as to your opinion about limitations on compensation, does everybody agree that there should be limitations on compensation during a reorganization? If so, what does the—what impact does that have in terms of the business's position in the overall marketplace?

And, number two, if you should have limitations on compensation, how can that be accomplished?

Mr. Silvers?

Mr. SILVERS. The AFL-CIO would like two specific things done in this area as part of the broader examination that Madam Chairwoman described as an effort to restore balance as a whole to the bankruptcy system.

The two specific things we would like are, one, the extension of broader review powers over executive comp from the KERP area, where we only look closely at retention, to look at the package as a whole, because of this issue of judges feeling like their hands are tied.

Secondly, we want executives who are contemplating making war on their employees, doing to people what was done to Ms. Muoneke, we want them before bankruptcy to realize that if they do so, what they do to others will happen to them. And that is the second principal we want embodied in law, and it is not a principal about how do you review comp after the fact, it is about what you have to think about beforehand when you are thinking about hurting other people in the way that hundreds of thousands of American workers have been hurt in this process.

Mr. JOHNSON. Okay. Do unto others as you would have them do unto you, perhaps, as a system of imposing that.

Mr. SILVERS. Pretty much.

Mr. JOHNSON. Let me ask, Mr. Levin, your position, and then Mr. Wintner, and then if you have got anything that you would like to say on that, Ms. Muoneke.

Mr. LEVIN. The National Bankruptcy Conference I think would not favor any limits on compensation per se. They are too hard to define. One-size-fits-all does not work.

I think our focus is more on making sure that executives are not in a position to line their own pockets, that the process prevents that, through the negotiation process and court supervision, imposing reasonableness standards.

You can't define what is reasonable in any particular case without understanding the facts.

Mr. JOHNSON. Does the law enable that process to take place right now or do we need some revisions of the law?

Mr. LEVIN. I think revisions would be appropriate. I think, as I noted——

Mr. JOHNSON. To give the judges more authority to gauge exactly how?

Mr. LEVIN. Well, right now the law permits incentive plans under a very broad standard and it effectively prohibits retention plans. And we think those could be brought more into balance.

Incentive plans are useful because if they work, people actually perform.

Mr. JOHNSON. All right.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I would now like to recognize Mr. Cohen for 5 minutes.

Mr. COHEN. Thank you, Madam Chair.

Before I start, I would like to yield as much time as he desires and needs to the honorable Chairman of this Judiciary Committee, Mr. Conyers.

Mr. CONYERS. Well, that is very kind of you, Mr. Cohen.

Mr. Levin, would you share my concerns, please, because all this emphasis on negotiation sounds very fair. Well, guess what? The corporations have a huge advantage sitting across from the union representatives because they will say, "Look, guys, if you don't go along, guess what? We are going to liquidate." And that is what they are doing now and that is what they will be doing after all this talk about fair negotiations is over with.

And I thank my colleague for yielding.

Mr. COHEN. Thank you, sir.

Mr. Levin, is there a system right now where if something shocks the conscience of the court, the court is supposed to act?

Mr. LEVIN. Yes. The court has the unquestioned authority to disapprove a transaction that is completely outside the bounds of reasonableness. I think the standard that would—I am having trouble coming up with the exact standard that the courts use, but certainly shock the conscience would get there.

Mr. COHEN. How often does that occur? What percentage of cases, do you think?

Mr. LEVIN. Well, since most of the cases where the court approves things—we are talking the executive comp area or are we talking more generally?

Mr. COHEN. Executive comp.

Mr. LEVIN. Okay. In the cases where the courts have approved things since the enactment of 503(c), there has been general agreement among the parties in the case, and so we haven't seen a situation where the court has approved something that one might say shocks the conscience, because there maybe disagreement about how reasonable it is, but it is not up to that standard and there is, as I said, objections and the comp plans have been withdrawn and the courts have approved.

The courts have disapproved where there has not been consensus, even on matters that don't quite shock the conscience but just are outside some bounds of reasonableness.

Mr. COHEN. Mr. Silvers, you brought to our attention Mr. Cooper and his turnaround for Enron, and I hate to say it, I guess in this room I talked about having some stock in one of those companies that kind of went south on the radio, I guess it was Sirius, and I had Enron too, so I am not real thrilled about his $100 million or whatever.

Did anybody object to his compensation?

Mr. SILVERS. Yes, in fact this is one instance where the U.S. Trustee objected to the final $25 million, it got cut in half, so it ended up being a final bonus of $12 million in the Enron case. But right at the margin, right.

And let me extend my condolences on behalf of the 10 million AFL-CIO members, pretty much every one of whom in some fashion or another also owned Enron.

Mr. COHEN. What was Mr. Silvers' hourly compensation—Mr. Cooper's, I am sorry.

Mr. SILVERS. Well, it is hard to say. He came in, and I think, because we don't actually know actually what he individually got out of this—he came in in December of 2001 and he was there, I think they were still doing it, it was in—it took several years. I forget the—it was 2 or 3 years.

If you figure he worked a hard couple of years, that he was at work, oh, maybe twice as much as most of us are, so 10,000 hours a year—no, that is 4,000 hours a year, say 3 years, that is 12,000 hours. You are talking about a very large number. $100 million divided—$10,000 an hour I think it comes out to.

Mr. COHEN. But did he bill an hourly rate or did he just bill a gross rate for his services?

Mr. SILVERS. Again, I think this is—let me edit what I just said. That is for the firm. We don't know—I couldn't tell you how many people, I am sure it is in the court record, were compensated as a result of that $120 million.

What we do know is that following this engagement, Mr. Cooper, who by the way, I don't mean to suggest he is a bad man or a crook or anything like that. He was a businessman, he went and did the job, he got paid. But he got paid an enormous amount of money, and the measure we have of that is that he was able to, in the most expensive real estate market perhaps in the world, he was able to buy one of the most expensive properties. And I think that tells us something about sort of what the pay out was at the end.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I am going to enquire of the members who are still present if there is interest in a second round of questioning. I know I have

a couple more questions I would like to ask, if anybody else is interested in asking questions? If not, I will just ask unanimous consent to—I would like unanimous consent for 3 additional minutes to ask questions.

Without objection, so ordered.

Mrs. Muoneke, can you tell us some of the concessions that the employees were forced to make as a result of going into the Chapter 11 bankruptcy? Some of the things that you guys gave up?

Ms. MUONEKE. The bulk of our concessions, other than pension, was work rules. Work rules is, like they govern our job at United, and we have had to give up quite a bit with that, which means we are working longer hours, our job responsibilities have increased two-fold, but we are paid less than what we were paid prior, but we are expected to do twice the amount of what we were initially—what our job description had initially set out for.

And job rules may not be a major thing to you, but for us, it is everything for us.

Ms. SÁNCHEZ. I am sure it governs childcare and numerous other issues.

Mr. Levin, I am interested, and I think Mr. Conyers made an excellent point about feeling sorry for the poor, beleaguered executive when we hear testimony about what the real rank and file worker gives up when they are making sacrifices for the company and the sacrifice doesn't seem to be equaled by those at the top, who always seem to be taken care of in one respect or the other.

I am interested to ask, Mr. Levin, do you think an airline can continue to exist without dedicated rank and file employees who do the day-to-day of the airline?

Mr. LEVIN. As Mr. Cannon said earlier, I too fly quite a lot, and I rely very heavily on those dedicated employees who are good at their jobs and careful in protecting our safety and our comfort while we are en route. They are critical.

Ms. SÁNCHEZ. Would it be safe to say that in the Chapter 11, yes, there is concern that you want to keep good management around, but shouldn't there also be an equal concern that you keep good employees around who will continue to make the business a going concern?

Mr. LEVIN. There is no question about that. I don't want to frame this, though, as a zero sum game.

Ms. SÁNCHEZ. I understand that. I think everybody was interested in making sure that the airline continued in business, because if not the rank and file sure don't get paid, nor do the executives. Although it seems to me that the way things are structured, which we have an inordinate amount of concern for keeping good management, but we don't have that same and equal concern about keeping good rank and file employees.

I mean, correct me if I am wrong, but usually in restructuring or in bankruptcy, one of the things that they tend to do is slash jobs and then give bonuses to executives because they are making the company leaner. I mean, who is bearing the bulk of the sacrifice in that scenario?

Mr. LEVIN. You are right. It is a very difficult question. We want to protect jobs. That is what Chapter 11 is about.

Companies sometimes over-expand, and the only way you can get them healthy again is by cutting them back. You can't cut a company back by keeping all of its suppliers, all of its workers, all of its other obligations, in an overexpansion situation. That is got to be done in the most humane and constructive way possible, in a way that is going to preserve the best value of the company for the stakeholders there.

I don't question that at all, that that is an important consideration in Chapter 11. But to try to preserve a company as it is when it went in, if it were healthy enough to do that, it wouldn't have needed to go into bankruptcy.

So it is difficult to sit here and dictate a balance that makes that work. All of those factors must be taken into consideration.

We are not arguing that there is any particular sympathy for the executives.

Ms. SÁNCHEZ. I understand that.

Mr. LEVIN. What we are simply saying, is like I mentioned earlier, the suppliers, if you tell suppliers that are shipping fuel to the airline, sorry, we are only gong to pay you 50 percent of the market price of the fuel, they will go sell elsewhere. And we want to keep the employees, but we don't want management to say—maybe in an industry like airlines there aren't other jobs and you don't need to worry about keeping them in a very—in an area where there is a very competitive labor market at the executive level.

It is not a question of concern for the executives. It is a concern to fill those jobs rather than having employ slots.

Ms. SÁNCHEZ. I understand that. I am just simply trying to point out the fact that there seems to be an inordinate amount of time and attention that is focused on preserving jobs or preserving executive positions, and less so on the rank and file members who can be let go summarily and, you know, who have already made concessions with respect to pension benefits or health care benefits or even wage or hour benefits. And you know, they are let go and nobody really cries, for them in the end. At least we are not looking to retain—we are not so focused on retaining those employees.

It seems to me that there is an imbalance in terms of how the value of each of their work is viewed.

Mr. CONYERS. Madam Chairman?

Mr. LEVIN. I didn't mean to suggest that at all, Madam Chair. So if I did, I apologize.

Ms. SÁNCHEZ. I understand.

Yes?

Mr. CONYERS. Madam Chairman, would you yield for just a momentary observation?

Ms. SÁNCHEZ. My time has expired, but I will unanimously recognize you for 1 minute, Mr. Chairman.

Mr. CONYERS. All right, thank you.

You know, gentlemen and lady, you know what bothers me, frankly? When you lay off a multi-millionaire and you lay off somebody making $40,000 a year, there is one hell of a difference. A person, an executive who loses his job, the worst thing that can happen to him, he is already wealthy. He is already in the top 1 percent, over $100,000 a year.

So to even pretend that losing an executive's job is the same as Ms. Muoneke losing her job doesn't even compute.

Ms. SÁNCHEZ. Thank you, Mr. Conyers.

I am also going to ask unanimous consent to include in the record additional statements by Patricia Friend, who is the international president of the Association of Flight Attendants.

Without objection, it is so ordered.

[The prepared statement of Ms. Friend can be found in the Appendix.]

Ms. SÁNCHEZ. There being no more questions, we would like to thank all the witnesses again for their testimony today.

Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer in as prompt a manner as you can, and those responses will also be made part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any additional material.

Again, I want to thank everybody for their time and patience at this hearing of the Subcommittee.

This hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 12:01 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE STEPHEN I. COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

I am interested in hearing from the witnesses regarding whether Congress needs to take legislative measures to address the practice of Chapter 11 debtors using sometimes-exorbitant "incentive" packages for their executives, particularly when those same debtors impose enormous financial hardships on their employees in the name of achieving a financial recovery. Congress has already addressed its concern regarding high executive compensation given by Chapter 11 debtors to their executives as retention compensation. It may be time to take a similar approach with respect to incentive-based compensation.

NEWS RELEASE CONCERNING AMERICAN AIRLINES FLIGHT ATTENDANTS' NATIONWIDE PROTEST

The Association of Professional Flight Attendants
1004 West Euless Boulevard
Euless, TX 76040
Tel. 817.540.0108 Fax. 817.540.2077

APFA
NEWS RELEASE

April 16, 2007
FOR IMMEDIATE RELEASE

Contact: Lori Bassani
817-540-0108, Ext. 8740

AMERICAN FLIGHT ATTENDANTS PROTEST NATIONWIDE

Flight Attendants Picket at 18 Airports against AA Bonuses and Broken Promises

Euless, TX (April 16, 2007) - American Airlines Flight Attendants, represented by the Association of Professional Flight Attendants (APFA), will be informational picketing at 18 airports nationwide tomorrow, Tuesday, April 17, from 10:00 a.m. to 2:00 p.m. local time. The flight attendants are protesting the fact that only 874 'elite' executives at American Airlines are set to reap the rewards all employees were promised to share in return for their sacrifices.

In 2003, employees of American brought their company back from the brink of bankruptcy by drastically cutting wages, work rules, benefits and jobs. "In 2003 all American employees stepped up to the plate and wouldn't take bankruptcy for an answer. Now, we are asking our company to make good on their promise to share the rewards of our labor that flight attendants and all employees have worked so hard to gain," said APFA President, Tommie L. Hutto-Blake.

Flight attendants will carry signs with slogans like, "Gloves are Off, Boots are On" (to step through company rhetoric), "Pulling Together or Pulling AApart?" (a spin on the company's slogan of 'Pull Together – Win Together') and will ask customers to sign get well cards for their company's speedy financial recovery and to seek customer support in restoring better customer service. Picketing will take place at 18 airports nationwide.

WHEN: Tuesday, April 17, from 10:00 a.m. to 2:00 p.m. (local time)

WHO: American Airlines Flight Attendants represented by APFA

WHY: To Protest AA 'Elite' Executive Bonuses and Unshared Gains

WHERE: 18 airports nationwide (please see attached document for details)

WEB SITE: www.apfa.org

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APFA is the nation's largest independent flight attendant union representing 20,000 American Airlines Flight Attendants.
www.apfa.org

SUBMISSION ENTITLED "2003 SACRIFICES FROM AA FLIGHT ATTENDANTS RESTRUCTURING AGREEMENT"

2003 Sacrifices from AA Flight Attendants Restructuring Agreement

Hourly pay rates were slashed by 15.6%

Many other types of pay were cut in half or eliminated.

Eliminated pay: (monthly amounts based on 75 hours)
Reserve override pay. $2/hour or $150/reserve month guarantee. $450/year loss.
Narrow body lead pay. $1.25/hour or $93.75/month; $1125/year loss.
Night pay $.30-.50/hour.
Longevity Pay; $1000-2250/year depending on seniority
Holiday Pay for 3 holidays.

Reduced pay: : (monthly amounts based on 75 hours)
Understaffing from $10 to $5/hour.
Domestic Purser pay reduced from $4.50 to $2.08/hour; $181.50/month; $2178/year loss.
International Purser pay reduced from $7 to $3/hour; $300/month; $3600/year loss.
International narrow body Purser pay reduced from $4.50 to $2; $187.50/month; $2250/year loss.
Speaker pay reduced from $2.50 to $1.25/hour; $93.75/month; $1125/year loss.
Domestic per diem pay reduced from $1.85 to 1.50/hour; $70/month; $840/year (based on 200 hours away from base)
International per diem pay reduced from $2.05 to $1.75/hours; $60/month; $720/year. (Based on 200 hours away from base)
E time pay and credit formulas reduced which translates to Flight Attendants get paid less for being on duty more.
Galley pay reduced by 50%
Training Pay for annual recurrent training. Increased from 8 to 12 hours of unpaid annual training.

Examples of loss of wages(all examples based on 75 hours/month):
A 7 year domestic Flight attendant without agreeing to sacrifices would have been paid $3017/month. $36,204/year flying 75 hours/month.
Today a 7 year Flight attendant earns $2569/month; $30,833/year (14.8% difference).

Therefore a 7 year flight attendant must fly almost 12 hours more/month to make the same amount of money which equates to 2 additional days of flying/month.

A 7 year domestic Purser before restructuring: $36,204 + $4,050 purser pay + $4,440 per diem = $44, 694/year.

Same 7 year domestic Purser now earns $30,833 + $1872 purser pay + $3,600 per diem = $36,305/year (almost 19% pay cut). This Flight Attendant would have to work 17 hours more/month to make the pre-restructuring amount which equates to 3 additional days of flying/month.

A 15 year international Flight Attendant without agreeing to sacrifices would have been paid $4242/month; $50,904/year flying 75 hours/month.
Today that same Flight Attendant earns $3612.50/month; $43,350/year (14.8% difference)

A 15 year international flight attendant must fly almost 12 hours more/month to make the same amount of money which equates to 2 additional days of flying/month.

A 15 year international Purser before restructuring would have made $50,904 + $6300 wide-body purser pay + $4920 per diem = $62,124/year.

Today a 15 year international Purser makes $43,350 + $2700 wide body purser pay + $4200 per diem = $50,250/year. (19% pay cut). This Flight Attendant would have to work 17 hours more/month to make the pre-restructuring amount which equates to 3 additional days flying/month.

Vacation Loss:
Each Flight Attendant lost 1/3 of their annual vacation accrual. A Flight Attendant at AA must work more than 5 years just to get 2 weeks of vacation. A Flight Attendant does not see 3 weeks of vacation until they've worked 20 years at AA. A Flight Attendant does not see 4 weeks vacation until they've worked 25 years or more.

Actual vacation breakdown:
Less than 5 years = 9 days
5-11 years = 14 days
12-19 years = 19 days
20-24 years = 23 days
25 and beyond = 28 days

Duty time & Rest
Domestic:
Minimum scheduled rest was reduced from 10 hours to 9.
On-duty maximums were increased. Scheduled from 12 ½ to 13; Maximum on duty from 14 to 15 hours.

Daily maximum flying time increased from 8 hours/duty period to 8.59.

The reality of reduced rest: Most domestic trips and International trips out of MIA to the Caribbean/Central America, flight attendants work 13 hour duty days with 10-12 layovers followed by another 13 hour duty day followed by another 10-12 hour layover followed by yet another 13 hour duty day. In actual operations, often the duty days increase to 14-15 hours, layovers shrink to 8-10 hours which includes travel time to/from hotels. Therefore, Flight Attendants rarely get 8 hours of sleep before/after 13-15 hour duty days with multiple flying legs (often 4 legs/day).

Sick Time accrual reduced from 5 to 3 hours/month.

SUBMISSION ENTITLED "AMERICAN AIRLINES FLIGHT ATTENDANT FACTS"

American Airlines Flight Attendant Facts

- 17,653 active flight attendants
- 2,345 furloughed flight attendants
- Contract amendable April 30, 2008
- 2003 Flight attendants took a 15.6% cut in pay, almost 30% when work rules, benefits and other pay is factored in.
- Flight attendants must now work an average of 3 days more per month to earn as much as pre-concessionary salary.
- Flight attendants find themselves working 13-15 hours duty days and have short layovers in which they can't even get 8 hours of sleep.
- 7 year flight attendant earns $31,000/year flying full-time.
- The flight attendant work group alone has given more than $1.36 billion in pay, work rule and benefit concessions since 2003.

SUBMISSION ENTITLED "APFA FACTS ON AMERICAN AIRLINES EXECUTIVE BONUS VS EMPLOYEE CONCESSIONS"

APFA FACTS On American Airlines
Executive Bonus vs Employee Concessions

American Airlines (AA) Operations Restructuring Plan

In 2003, more than 80,000 AA employees voluntarily provided concessions totaling 1.6B in annual cost savings to avoid bankruptcy.

Flight attendants have surrendered more than $345M per year since 2003.

As a result of shared sacrifices, AA avoided filing for bankruptcy protection which would have completely eliminated shareholder value.

Over the past four years, employee sacrifices provided 6.4B to help turn the company around.

Instead of being worthless, AA parent company, AMR, share values have increased nearly 2000% since the stock bottomed out just prior to concessionary agreements.

AAs New Labor-Management Collaborative Business Model

Following the painful restructuring process, AA and its labor unions boldly set out on a new path to change the corporate culture at American.

Senior AA management referred to Union leaders as business partners and took a vow of transparency.

Labor leaders, though cautiously optimistic, took the high road to join management in returning their airline to sustained profitability.

Phrases used during this era of the Turnaround Plan included Pull Together-Win Together, Shared Sacrifice-Shared Gain and was an attempt to build trust of the frontline employees, considered critical in the recovery plan.

Executive Compensation

Under a management only stock based performance incentive program a small group of AMR executives received nearly $100M in stock grants and cash in April 2006

This first shock wave spelled the beginning of the end of joint work between American and the APFA and Allied Pilots Association (APA). Both unions promptly pulled out of an initiative designed to seek more productivity from its employees.

The bonus payout on April 19, 2007 to only 874 elite executives is estimated at about $200M in stock awards - final calculation is based on stock price at closing on April 18.

Corporate executive compensation is getting out of control. It has increased over 250% in the past decade for large U.S. corporations.

In 2000, the average CEO to average worker pay was 511 to 1.

Association of Professional Flight Attendants (APFA) represents the 20,000 flight attendants at American Airlines – www.apfa.org

PREPARED STATEMENT OF PATRICIA A. FRIEND, INTERNATIONAL PRESIDENT, ASSOCIATION OF FLIGHT ATTENDANTS—CWA, AFL-CIO

Chairman Sánchez and members of the subcommittee, thank you for holding this timely hearing and exposing a troubling trend that threatens to erode the great American middle class and damage workers confidence in our economic system.

My name is Patricia A. Friend and I am the International President of the Association of Flight Attendants—CWA (AFA-CWA), AFL-CIO. AFA-CWA represents over 55,000 flight attendants at 20 different airlines throughout the United States and is the world's largest flight attendant union.

When companies enter bankruptcy, employees are the first to suffer the consequences as management demands drastic pay and benefit reductions. To add insult to injury, management then shops for potential investors, using their employees reduced standard of living as a selling point in hopes of exiting bankruptcy with large sums of fresh capital. Employees then scrimp to get by as management gouges on new investments and rewards themselves outrageous bonuses.

Can you see why employees feel exploited?

Can you imagine the anger and outrage that working Americans feel when their sacrifices bankroll bonuses and higher standards of living for a few executives.

Corporate executive compensation in the United States is off the charts, but in the airline industry, the abuse is at its worst. In 2005, American executives paid themselves at a rate more than 400 times that paid to rank-and-file employees—a disparity in wages not seen since the 1920s—and, in 2006, the median CEO compensation increased 48 percent to $30.2 million Nowhere is the injustice of the great wage divide more palpable than in the executive suites of our nation's airlines.

Since congress passed the Airline Deregulation Act of 1978, one-hundred-sixty (160) carriers have filed for bankruptcy and aviation workers have for too long paid the price for mismanagement. The lessons should have been clear from this tragic track record, yet congress and our judicial system have ignored the best interests of American workers and have been complicit in allowing executives the use of our bankruptcy system to enrich themselves at the cost of their employees.

Recent examples highlight why congress should take immediate action to address this great injustice.

The moment United Airlines emerged from bankruptcy, company managers raided its coffers. Far exceeding even the median money grab, United Airlines CEO Glenn Tilton took $39.7 million in 2006 compensation. This, after cutting its work force by 25 percent, dumping its workers' under funded pensions and extracting profound sacrifices from its employees during its three years in bankruptcy.

Incredibly, Mr. Tilton's compensation package was greater than the entire profit at United Airlines for 2006. This case alone should compel you to act. Sadly however, there is fresh and ample evidence of excessive greed in airlines executive suites.

At Northwest Airlines, management recently disclosed a plan to exit bankruptcy that would reward its top 400 executives with an average of $1 million each and give nothing back to flight attendants whose wages, benefits and working conditions have been decimated in bankruptcy. Last year, after flight attendants at US Airways endured massive pay cuts over several years, the airline's executives rewarded themselves multiple million in stock bonuses and double-digit pay increases. Employees at American Airlines have not been compensated for the $1.6 billion in concessions they gave in 2003 to keep their airline out of bankruptcy, while AMR CEO Gerard Arpey took more than $7.5 million in a stock award for 2006.

Congress must take action to rein in management's use of our bankruptcy system to raid the coffers of American companies, some of whom were built by generations of hard working employees. Our judicial system is complicit in this growing greed. Our courts have largely ignored the pleadings of employees in bankruptcy cases providing no protection for those most vulnerable when a company reorganizes.

Can any of us remember the last time a bankruptcy court rejected a compensation package for management?

Irresponsible management of our nation's airlines has been taken to an extreme. As if in a winner-take-all game of Monopoly, airline executives seem to be on an unstoppable trajectory, with greed as the only rule of the game. Your efforts to put an end to excessive compensation and to rectify bankruptcy laws will serve the greater interests of all working people who depend on a healthy and just economy.