

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:))))	Chapter 11
))))	
CONEXANT SYSTEMS, INC., <i>et al.</i> , ¹))))	Case No. 13-10367 ()
))))	
Debtors.))))	Joint Administration Requested

**DEBTORS' MOTION FOR ENTRY OF
INTERIM AND FINAL ORDERS AUTHORIZING, BUT
NOT DIRECTING, THE DEBTORS TO (A) PAY PREPETITION
EMPLOYEE WAGES, OTHER COMPENSATION AND REIMBURSABLE
EMPLOYEE EXPENSES AND (B) CONTINUE EMPLOYEE BENEFITS PROGRAMS**

Conexant Systems, Inc. and its debtor affiliates, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "*Debtors*"),² respectfully represent:

Jurisdiction

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).
2. Venue in this Court is proper pursuant to 28 U.S.C. §§ 1408 and 1409.
3. The bases for the relief requested herein are sections 105(a), 363 and 507(a)(4)-(5), 1107 and 1108(a) of the Bankruptcy Code, Rules 6003 and 6004(h) of the Federal Rules of

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal taxpayer-identification number, are: Conexant Systems, Inc. (9439); Conexant CF, LLC (6434); Brooktree Broadband Holding, Inc. (5436); Conexant, Inc. (8218); and Conexant Systems Worldwide, Inc. (0601). The Debtors' main corporate address is 4000 MacArthur Blvd., Newport Beach, California 92660.

² A detailed description of the Debtors and their businesses, and the facts and circumstances supporting this motion and the Debtors' chapter 11 cases, are set forth in greater detail in the Declaration of Sailesh Chittipeddi, President and CEO of Conexant Systems, Inc., in Support of First Day Pleadings (the "*First Day Declaration*"), filed contemporaneously with the Debtors' voluntary petitions for relief filed under chapter 11 of title 11 of the United States Code (the "*Bankruptcy Code*"), on February 28, 2013 (the "*Petition Date*").

Bankruptcy Procedure (the “*Bankruptcy Rules*”) and Rule 9013-1(m) of the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the “*Local Rules*”).

Relief Requested

4. To minimize the personal hardship that the Debtors’ various employees will suffer if certain prepetition amounts are not paid when due or as expected, and to maintain the morale of an essential workforce during this critical time, the Debtors request entry of interim and final orders, substantially in the forms attached hereto as **Exhibit A** and **Exhibit B** (the “*Interim Order*” and the “*Final Order*,” respectively), (a) authorizing, but not directing, the Debtors to pay prepetition wages, salaries, other compensation and reimbursable employee expenses, (b) authorizing, but not directing, the Debtors to continue employee benefits programs, (c) authorizing financial institutions to receive, process, honor and pay all related checks and electronic payment requests for payment of prepetition employee obligations (collectively, and as described herein, the “*Employee Obligations*”)³ and (d) scheduling a final hearing (the “*Final Hearing*”) to consider entry of the Final Order (to the extent a Final Hearing is necessary).

5. Given that the Debtors’ employees are integral to the Debtors’ ability to operate their businesses during these chapter 11 cases, the Debtors’ failure to satisfy certain Employee Obligations within the first 21 days of these chapter 11 cases would jeopardize employee loyalty, morale and trust, possibly causing employees to leave the Debtors’ employ and thereby

³ The summary of the Debtors’ various Employee Obligations provided herein is qualified entirely by the Debtors’ official policies or other practices, programs or agreements, whether written or unwritten, evidencing an arrangement among the Debtors and their Employees (as defined herein) (each, an “*Official Policy*”). In the event of any inconsistency or ambiguity between the summary contained in this motion and an Official Policy, the terms of such Official Policy shall govern. The Official Policies are not contractual commitments of the Debtors.

significantly harming the Debtors' operations at this critical juncture. Accordingly, pursuant to the Interim Order, the Debtors seek the authority, but not the direction, to continue to honor, pay, satisfy or remit all claims and prepetition obligations related to Employee Obligations subject to the limitations discussed herein.

6. Lastly, the Debtors will seek the authority, solely upon entry of the Final Order, to honor, pay, satisfy or remit certain claims and prepetition obligations related to the following Employee Obligations (each as defined and discussed herein): (a) Unpaid Vacation Time owed to the Debtors' current and former Employees, to the extent that such prepetition amounts are outstanding, and (b) Unpaid Reimbursable Expenses.

Basis for Relief

A. Overview of the Debtors' Workforce

7. As described in the First Day Declaration, as of the Petition Date, the Debtors and their non-Debtor affiliates employ approximately 406 employees worldwide. The Debtors employ approximately 205 employees (the "*Employees*"), of which approximately 202 are located in the United States (the "*U.S.*") and 3 are located in France. In addition, the Debtors supplement their business needs and workforce with approximately 37 independent contractors (the "*Independent Contractors*").

8. The Employees and Independent Contractors perform a variety of critical functions, including sales, customer service, purchasing as well as administrative, accounting, legal, finance, management, supervisory and other related tasks. Their skills, knowledge and understanding with respect to the Debtors' operations, customer relations and infrastructure are essential to the effective reorganization of the Debtors' businesses.

9. Just as the Debtors depend on the Employees and Independent Contractors to operate their businesses on a daily basis, these individuals also depend on the Debtors. Indeed, the vast majority of these individuals rely exclusively on payments received from the Debtors for their basic living necessities.

B. Wages, Payroll and Other Compensation

(i) Wage Obligations

10. In the ordinary course of business, the Debtors incur payroll obligations for base wages owed to their Employees and Independent Contractors (collectively, the “*Wage Obligations*”). A majority of the U.S. Employees’ Wage Obligations are paid on bi-weekly basis, without arrearage, while the remaining U.S. Employees’ Wage Obligations are paid on a bi-weekly basis one week in arrears. French Employees are typically paid on a monthly basis. Independent Contractors are paid on a weekly or monthly basis. On a bi-weekly basis, the Debtors estimate that Wage Obligations average a total of approximately \$1.2 million.

11. The Debtors’ U.S. payroll is administered by Automatic Data Processing, Inc. (“*ADP*”), a third-party service provider, which distributes payroll, either directly to the U.S. Employees via check or through direct deposits with funds advanced by the Debtors to ADP. The Debtors’ payroll for the period ending February 22, 2013 has already been paid to ADP and debited from the Debtors’ payroll account. Nonetheless, certain limited prepetition payroll amounts may remain unpaid as of the Petition Date because, among other things, wire transfers may not have been effectuated or various checks may not have cleared before the Petition Date.

12. Specifically, outstanding prepetition Wage Obligations include the following (collectively, the “*Unpaid Compensation*”):

- a. Employee Compensation. Employee compensation consists of amounts owed to the Debtors’ exempt and non-

exempt Employees, including prepetition wages, salaries and sales incentives but excluding severance and vacation time. The Debtors' aggregate bi-monthly payments to Employees on account of Employee compensation total approximately \$1.1 million. As of the Petition Date, the Debtors estimate that they owe approximately \$300,000 on account of Employee compensation in the ordinary course of business.

- b. Independent Contractor Compensation. The Debtors' aggregate monthly payments to Independent Contractors total approximately \$315,000. As of the Petition Date, the Debtors estimate that approximately \$70,000 has accrued and remains outstanding on account of prepetition services provided by Independent Contractors, each of whom are individuals, and none of whom are owed in excess of \$11,725 on an individual basis.

13. By this motion, the Debtors seek the authority to pay and honor the Unpaid Compensation in an amount not to exceed \$11,725 per eligible Employee or Independent Contractor, and continue to honor the Wage Obligations on a postpetition basis in the ordinary course of business.

(ii) Unpaid Payroll Service Fees

14. The majority of the Debtors' Wage Obligations are made by direct deposit through the electronic transfer of funds from the Debtors' payroll department to ADP, which then directly transfers funds to each Employee's bank account, with the remaining Employees receiving checks.

15. Specifically, ADP is responsible for serving as the Debtors' payroll and federal W-2 tax form processing vendor, as well as completing the Debtors' payroll tax filings, including federal, state and local tax filings. In addition, for each payroll period, ADP processes direct deposit transfers, and administers payroll checks to Employees from certain disbursement accounts funded by the Debtors with the amounts necessary to satisfy the Debtors' payroll

obligations. ADP is crucial in providing the Debtors with a payroll system that functions seamlessly.

16. The Debtors incur approximately \$70,000 per year in fees for ADP's services. As of the Petition Date, the Debtors estimate that approximately \$6,000 has accrued and remains outstanding on account of fees owed to ADP for services rendered prepetition (the "*Unpaid Payroll Service Fees*"). By this motion, the Debtors seek authority to remit the Unpaid Payroll Service Fees and continue to use ADP in the ordinary course of business on a postpetition basis.

C. Deductions and Payroll Taxes

17. During each applicable pay period, the Debtors routinely deduct certain amounts from Employees' gross pay, including garnishments, child support and similar deductions (collectively, the "*Deductions*"), which either the Debtors or a third-party service provider then forwards to the appropriate recipients. On a bi-weekly basis, the Debtors estimate that Deductions total approximately \$132,000. As of the Petition Date, the Debtors estimate that approximately \$44,000 in Deductions have been collected but not yet remitted to the appropriate third-party recipients (collectively, the "*Unremitted Deductions*").

18. In addition to the Deductions, the Debtors are required by law to withhold amounts from U.S. Employees' wages that are related to federal, state and local income taxes, including social security and Medicare taxes and employment insurance, for remittance to the appropriate taxing authorities (collectively, the "*Employee Payroll Taxes*"). On a bi-weekly basis, the Debtors estimate that Employee Payroll Taxes total approximately \$300,000 for U.S. Employees.

19. The Debtors must match from their own funds social security and Medicare taxes and pay, based on a percentage of gross payroll, additional amounts for federal and state

unemployment insurance (collectively, the “*Employer Payroll Taxes*” and, together with the Employee Payroll Taxes, the “*Payroll Taxes*”). The U.S. Payroll Taxes, including portions paid by the Debtors and portions paid by the Employees, total approximately \$450,000 per bi-weekly pay-period. As of the Petition Date, the Debtors estimate that approximately \$223,000 in Payroll Taxes has been collected for U.S. Employees and \$38,000 for French Employees but not yet remitted to the appropriate third-party recipients (collectively, the “*Unremitted Payroll Taxes*”).

20. The Debtors believe that because the Unremitted Deductions and certain Payroll Taxes are held for payment to third-parties, they are properly deemed to be held in trust, and thus, do not constitute property of the Debtors’ estates.⁴ Out of an abundance of caution, however, the Debtors seek authority to remit the Unremitted Deductions and Unremitted Payroll Taxes and continue collecting and remitting the Unremitted Deductions and Unremitted Payroll Taxes in the ordinary course of business on a postpetition basis.

D. Reimbursable Expenses

21. In the ordinary course of business, the Debtors reimburse certain Employees for reasonable, customary and approved expenses incurred on behalf of the Debtors in the scope of their employment and service, including travel expenses and credit cards,⁵ in accordance with the Debtors’ policies (collectively, the “*Reimbursable Expenses*”).

⁴ In the ordinary course, the Debtors submit the Unremitted Deductions and Unremitted Payroll Taxes to ADP which then remits the funds to the appropriate third-party recipients.

⁵ The Debtors reimburse approximately 51 Employees each month for business-related expenses purchased with a credit card (collectively, the “*Employee Credit Cards*”). All participating Employees are personally liable for charges incurred on the Employee Credit Cards. The Debtors also have approximately eight purchasing or credit cards that are billed directly to the Debtors; all related expenses are approved by management and the individual employees holding these cards are personally liable for unapproved expenses. With respect to certain other credit cards, the participating Employees pay directly and are subsequently reimbursed by the Debtors.

22. As of the Petition Date, the Debtors estimate that the total prepetition amount with respect to all Reimbursable Expenses is approximately \$20,000⁶ (collectively, the “*Unpaid Reimbursable Expenses*”). To avoid unnecessary disruption, the Debtors seek the authority, solely pursuant to the Final Order, to pay the Unpaid Reimbursable Expenses and continue to honor Reimbursable Expenses in the ordinary course of business on a postpetition basis.

E. Sales Incentives Program

23. In an effort to become a leading provider of fabless semiconductors, the Debtors employ approximately five Employees who provide a “sales” function to market the Debtors’ products to customers and retain their business. The Debtors reward those Employees whose sales meet internal revenue goals or directly account for certain of the Debtors’ “design wins” and “design ins” (the “*Sales Incentive Program*”). A design win occurs when one of the Debtors’ original equipment manufacturers (each, an “*OEM*”) adopts a certain configuration and places a volume production order for potential implementation into its products. A design in occurs when an OEM committed to implementing a design utilizing the Debtors product. All Employee claims for a design win or a design in are reviewed for accuracy by marketing, sales and financial personnel.

24. As of the Petition Date, there are no amounts due under the Sales Incentive Program. To continue incentivizing their sales Employees, the Debtors seek the authority, pursuant to the Interim Order, to continue to offer the Sales Incentive Program in the ordinary course of business on a postpetition basis.

⁶ No Employee is owed in excess of \$11,725 in Reimbursable Expenses.

F. Employee Benefits Plans

25. The Debtors maintain various employee benefit plans and policies, including health care, prescription drug benefits, dental and vision plans and flexible benefits plans (collectively, and as discussed in more detail below, the “*Employee Benefits Plans*”).

(i) Health Benefits

26. All regular, full-time, Employees are eligible to receive medical, prescription drug, dental and vision insurance coverage (collectively, the “*Health Benefits*”).

- a. Medical and Prescription Drug Plans. Anthem Blue Cross Life and Health Insurance Company administers the Debtors’ domestic medical and prescription drug coverage plans for approximately 231 covered Employees (the “*Medical Plan*”). The Debtors’ average monthly cost to administer the Medical Plan is approximately \$170,000, net of Employee contributions. As of the Petition Date, the Debtors estimate that they owe \$186,000 in prepetition obligations under the Medical Plan.
- b. Dental Plan. Delta Dental administers the Debtors’ dental plans for approximately 229 covered Employees (the “*Dental Plan*”). The Debtors’ average monthly cost to administer the Dental Plan is approximately \$23,000. As of the Petition Date, the Debtors estimate that they owe \$25,000 in prepetition obligations to Delta under the Dental Plan.
- c. Vision Plan. Vision Service Plan administers the Debtors’ vision benefits plan for approximately 222 Employees (the “*Vision Plan*”). The Vision Plan is almost completely funded by the participating Employees. The Debtors’ average monthly cost to administer the Vision Plan is approximately \$3,200. As of the Petition Date, the Debtors estimate that they owe a *de minimis* amount of prepetition obligations to Vision Service Plan under the Vision Plan. The Debtors seek authority, out of an abundance of caution, to forward the Employee contributions and to continue the Vision Plan in the ordinary course of business.
- d. Stop-Loss Insurance. As part of the Health Benefits, the Debtors have purchased stop-loss insurance through Sun Life Assurance Company of Canada (“*Sun Life*”) that

provides additional protection against large claims made by Employees that are above \$150,000 deductible under the self-insured Medical Plan (the "**Stop Loss Insurance**"). Stop Loss Insurance is an integral part of the Debtors' management of the risk of the self-insured medical plan and loss of the coverage would subject the Debtors to undue risk. The Debtors pay approximately \$26,000 per month to Sun Life in premiums for stop loss insurance. As of the Petition Date, the Debtors are current on their payments to Sun Life for premiums on the Stop Loss insurance.

- e. Employee Enrollment Administration. Hewitt Associates LLC (d/b/a Aon Hewitt) ("**Aon Hewitt**") currently provides on-line employee benefits enrollment services (*i.e.*, continuous enrollment due to employee status changes), a call center for participant questions and issues and coordination of the electronic transfer of benefits elections to the Debtors' health and insurance providers' enrollment systems (collectively, "**Employee Enrollment Administration**"). The Debtors' average monthly cost for Employee Enrollment Administration is approximately \$14,000. As of the Petition Date, the Debtors estimate that they owe \$60,000 in prepetition obligations to Aon Hewitt for Employee Enrollment Administration.

27. In addition to the amounts owed on account of Health Benefits, the Debtors have collected \$34,000 pursuant to payroll deductions for Health Benefits, which funds are held in trust and which the Debtors seek to remit to the appropriate third-party health providers on behalf of the Employees (collectively, the "**Unpaid Health Benefits**"). Considering that the Health Benefits are vital to the Debtors' Employees and that the Unpaid Health Benefits are held in trust for the Employees, and therefore, not property of the Debtors' estates, the Debtors seek the authority to remit the Unpaid Health Benefits. The Debtors also seek to continue providing the Health Benefits in the ordinary course of business on a postpetition basis.

(ii) Flexible Benefits Plan

28. The Debtors offer all of their full-time Employees the ability to contribute a portion of their pre-tax compensation to flexible spending accounts to pay for eligible, out-of-pocket health care and dependent care costs and expenses (the “*Flexible Benefits Plan*”). The Flexible Benefits Plan is administered by Your Spending Account® (“*YSA*”). The Debtors estimate that approximately 131 Employees participate in the Flexible Benefits Plan.

29. The Flexible Benefits Plan is fully funded by Employee contributions. The Debtors forward those contributions, in addition to certain administrative fees, to YSA on behalf of the applicable Employees. As of the Petition Date, the Debtors hold approximately \$12,000 in Employee contributions to the Flexible Benefits Plan (the “*Flexible Benefits Plan Obligations*”). Thus, amounts contributed pursuant to the Flexible Benefits Plan are not assets of the Debtors’ estates; rather, these amounts are held in trust for the participating Employees. The Debtors request the authority to forward the Flexible Benefits Plan Obligations if and when they become due and continue offering the Flexible Benefits Plan in the ordinary course of business on a postpetition basis.

G. Employee Workers’ Compensation, Insurance Plans and Disability Benefits

(i) Workers’ Compensation Programs

30. The Debtors maintain workers’ compensation insurance for their Employees at the mandated level required by each state in the U.S. in which the Debtors operate (the “*Workers’ Compensation Program*”). The Debtors maintain their Workers’ Compensation Program with Travelers Indemnity Company (“*Travelers*”). The Debtors pay a total of approximately \$116,000 in annual premiums for the Worker’s Compensation Policy, which are paid in monthly installments of approximately \$9,300 per month with a down payment of \$33,000.

31. As of the Petition Date, the Debtors estimate that they do not owe any prepetition Workers' Compensation Policy premium obligations (the "*Unpaid Workers' Compensation Premiums*"). By this motion, the Debtors request the authority to continue the Workers' Compensation Program in the ordinary course of business on a postpetition basis.

(ii) *Disability, Life and Accidental Death and Dismemberment Insurance*

32. Most of the Debtors provide short-term disability, long-term disability, basic term life and accidental death and dismemberment insurance coverage for their full-time Employees (at no cost to the Employees) (the "*Employee Insurance Coverage*"). Employees have the option to purchase supplemental insurance coverage for themselves, their spouse and/or eligible dependents. Hartford Life & Accident Insurance Company ("*Hartford*") provides the Employee Insurance Coverage.

33. As of the Petition Date, in addition to the Debtors' *de minimis* prepetition obligation owed on account of Employee Insurance Coverage, the Debtors also hold less than \$1,000 in Employees' premiums for supplemental insurance coverage, collected pursuant to payroll deductions, in trust for payment to third-party providers (collectively, the "*Unpaid Employee Insurance Coverage*"). By this motion, the Debtors seek the authority to remit the Unpaid Employee Insurance Coverage amounts and continue offering Employee Insurance Coverage in the ordinary course of business on a postpetition basis.

H. Vacation Time, Leaves of Absence and Paid Holidays

34. The Debtors provide all full-time Employees with vacation time as a paid, time-off benefit ("*Vacation Time*"). The amount of available Vacation Time, and the rate at which such Vacation Time accrues, is generally determined by the Employee's length of full-time

employment. Employees can receive between three to five weeks of Vacation Time per year.⁷

35. Upon termination, the Employee's final paycheck will include any available, unused Vacation Time. An Employee's unused Vacation Time, however, may not be used at the end of an Employee's active period of employment to lengthen their service or allow them to receive other benefits. As of the Petition Date, the Debtors estimate that they are responsible for Vacation Time totaling approximately \$1.7 million (the "*Unpaid Vacation Time*"). This amount, however, is not a current cash pay obligation as Employees are only entitled to be paid for accrued and unused Vacation Time upon termination. Thus, the Debtors do not have any outstanding cash obligations on account of Unpaid Vacation Time.

36. The Debtors also maintain a policy whereby Employees receive compensation for certain non-working holidays (the "*Paid Holidays*"). The Debtors observe eight Paid Holidays at their U.S. locations per calendar year.

37. By this motion, the Debtors seek the authority, solely upon entry of the Final Order, to remit the Unpaid Vacation Time (if any) when such obligations become due and owing and continue honoring Vacation Time and Paid Holidays in the ordinary course of business on a postpetition basis. Moreover, the Debtors anticipate that their Employees will utilize any accrued Vacation Time in the ordinary course of business, which will not create any material cash flow requirements beyond the Debtors' normal payroll obligations.

I. 401(K) Retirement Savings Plan

38. The Debtors maintain a retirement savings plan for the benefit of all eligible Employees that meets the requirements of section 401(k) of the Internal Revenue Code (the

⁷ Certain Employees in California are permitted to carryover limited amounts of Vacation Time into a subsequent calendar year as required pursuant to state law.

"401(k) Plan"). Approximately 155 Employees participate in the 401(k) Plan, which is administered by Fidelity Brokerage Services LLC ("*Fidelity*"). The Debtors match 33.33% of each pretax or post tax dollar that is contributed on the first 6% of deferred pay (the "*Matching Contributions*"). The Matching Contributions vest automatically once contributed. Previously, Matching Contributions vested over time and were subject to forfeiture when an Employee left the Debtors employ. Fidelity currently maintains approximately \$240,000 in forfeited Matching Contributions (the "*Forfeited Amounts*") that is used to offset current Matching Contributions and administrative costs as permitted under the plan. The Debtors expect that the Forfeited Amounts will offset the Matching Contributions, and therefore, they will not have to directly contribute to the 401(k) Plan in 2013.

39. Additionally, the Debtors withhold approximately \$200,000 (in the aggregate) each month from participants' paychecks on account of their 401(k) contributions. As of the Petition Date, the Debtors hold in trust approximately \$33,000 ("*Unremitted 401(k) Contributions*") in Employee 401(k) Plan contributions. The Debtors seek the authority to continue using the Forfeited Amounts towards the Matching Contributions outstanding as of the Petition Date, release the Unremitted 401(k) Contributions held in trust for their Employees and continue operating the 401(k) Plan in the ordinary course of business on a postpetition basis.

J. Immigration Assistance Program

40. The Debtors maintain an immigration assistance program (the "*Immigration Assistance Program*"), whereby the Debtors assist employees in obtaining an appropriate temporary (nonimmigrant) visa and nonimmigrant status authorizing employment with the Debtors. In addition, upon satisfaction of certain conditions, the Debtors may also assist the Employee in seeking permanent residence through available legal immigration options. Nothing

in the Immigration Assistance Program is intended to imply or express a promise of employment for a fixed period of time and nothing in this policy changes the at-will nature of an Employee's employment. The Debtors will generally pay all legal fees, filing fees and costs associated with a nonimmigrant petition for the Employee and his or her spouse and dependent children, with the exception of expenses for accommodations, incidentals and travel related to the application.

41. As of the Petition Date, the Debtors estimate that prepetition obligations under the Immigration Assistance Program total approximately \$12,000 (the "*Immigration Assistance Program Obligation*"). By this motion, the Debtors seek the authority pursuant to entry of the Final Order to satisfy the Immigration Assistance Program Obligation and continue the Immigration Assistance Program on a postpetition basis.

K. Tuition Reimbursement Plan

42. The Debtors maintain a tuition reimbursement policy for full time Employees for courses conducted by an accredited institution that are directly related to an Employee's current job or a job to which the employee may be transferred or promoted or considered by management to be in the best interest of the Debtors (the "*Tuition Reimbursement Plan*"). Under the Tuition Reimbursement Plan, Employees may receive up to \$7,500 per year for eligible courses. On average, the Debtors remit approximately \$8,000 per year to eligible Employees on account of the Tuition Reimbursement Plan. As of the Petition Date, there are no amounts outstanding under the Tuition Reimbursement Plan. By this motion, the Debtors seek the authority to continue the Tuition Reimbursement Plan in the ordinary course of business on a postpetition basis.

L. Mobile Phone Program

43. The Debtors provide certain Employees with a monthly mobile telephone

allowance to supplement the cost of their mobile phone expenses in the ordinary course of their duties (the “*Mobile Phone Program*”). On average, the Debtors remit approximately \$15,000 per month to eligible Employees on account of the Mobile Phone Program. As of the Petition Date, accrued and unpaid amounts under the Mobile Phone Program total approximately \$15,000 (the “*Mobile Phone Program Obligations*”). By this motion, the Debtors seek the authority, pursuant to the Final Order, to satisfy the Mobile Phone Program Obligations and continue the Mobile Phone Program on a postpetition basis.

Supporting Authority

A. The Court Should Authorize the Debtors to Honor Their Employee Obligations

(i) *Certain of the Employee Obligations are Entitled to Priority Treatment*

44. Pursuant to sections 507(a)(4) and (5) of the Bankruptcy Code, certain of the unpaid prepetition Employee Obligations – including Unpaid Wage Obligations – are entitled to administrative expense priority treatment in an amount up to \$11,725 for each individual Employee or Independent Contractor. To the extent such claims are afforded administrative priority status, the Debtors are required to pay these claims in full to confirm a chapter 11 plan. *See* 11 U.S.C. § 1129(a)(9)(b) (requiring payment of certain allowed unsecured claims for (a) wages, salaries or commissions, including vacation, severance and sick leave pay earned by an individual, and (b) contributions to an employee benefit plan).

45. In addition, and as noted above, the Debtors are not seeking authority to pay Unpaid Wage Obligations in amounts that exceed \$11,725 per Employee or Independent Contractor. Accordingly, granting the relief sought with respect to compensation only affects the timing of payments to Employees or Independent Contractors, and does not have any material negative impact on recoveries for general unsecured creditors. Indeed, the Debtors submit that

payment of Wage Obligations up to \$11,725 per individual will enhance value for the benefit of all stakeholders because it will help ensure that the Employees – the lifeblood of the Debtors' business operations – continue to provide vital services to the Debtors at this critical juncture. The Debtors believe that finding and attracting qualified talent would be extremely difficult and most likely would require higher salaries, guaranteed bonuses and overall higher cost compensation packages than are currently provided to the Debtors' Employees, should the Debtors be unable to honor the Employee Obligations when due and payable.

(ii) *Payment of Certain of the Employee Obligations is Required by Law*

46. The Debtors also seek authority to pay Deductions and Payroll Taxes to the appropriate entities. These amounts principally represent Employee earnings that Employees, governments and judicial authorities have designated for deduction from Employees' paychecks. Indeed, certain deductions, including contributions to the Employee Benefits programs and child support and alimony payments, are not property of the Debtors' estates because the Debtors have withheld such amounts from Employees' paychecks on another party's behalf. *See* 11 U.S.C. § 541(b).

47. Further, federal and state laws require the Debtors to withhold certain tax payments from Employees' paychecks and to pay such amounts to the appropriate taxing authority. *See* 26 U.S.C. § 6672 and 7501(a); *see also City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 95-97 (3d Cir. 1994) (finding that state law requiring a corporate debtor to withhold city income tax from its employees' wages created a trust relationship between debtor and the city for payment of withheld income taxes); *In re DuCharmes & Co.*, 852 F.2d 194, 196 (6th Cir. 1988) (noting that individual officers of a company may be held personally liable for failure to pay trust fund taxes). Because the Unremitted Deductions and Unremitted Payroll Taxes are not property

of the Debtors' estates, the Debtors request that the Court authorize the Debtors to transmit the Unremitted Deductions and Unremitted Payroll Taxes to the proper parties in the ordinary course of business.

48. Similarly, state laws require the Debtors to maintain the Workers' Compensation Program. If the Debtors fail to maintain the Workers' Compensation Program, state laws may prohibit the Debtors from operating in those states, and therefore is crucial to the continued operation of the Debtors' businesses.

B. Payment of the Employee Obligations is Warranted Under the Doctrine of Necessity

49. Courts generally acknowledge that, under appropriate circumstances, they may authorize a debtor to pay (or provide special treatment for) certain prepetition obligations. *See, e.g., In re Just for Feet, Inc.*, 242 B.R. 821, 824-45 (Bankr. D. Del. 1999) (noting that, in the Third Circuit, debtors may pay prepetition claims that are essential to the continued operation of the debtor's business); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (granting the debtor the authority to pay prepetition wages); *Armstrong World Indus., Inc. v. James A. Phillips, Inc.*, (*In re James A. Phillips, Inc.*), 29 B.R. 391, 398 (Bankr. S.D.N.Y. 1983) (granting the debtor the authority to pay prepetition claims of suppliers who were potential lien claimants). When authorizing payments of certain prepetition obligations, courts have relied upon several legal theories rooted in sections 1107(a), 1108, 363(b) and 105(a) of the Bankruptcy Code.

50. Pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, debtors in possession are fiduciaries charged with "holding the bankruptcy estate[s] and operating the business[es] for the benefit of [their] creditors and (if the value justifies) equity owners." *In re CoServ, L.L.C.*, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002). Inherent in a debtor in possession's

fiduciary duties is the obligation to “protect and preserve the estate, including an operating business’s going-concern value,” which, in certain instances, can be fulfilled “only . . . by the preplan satisfaction of a prepetition claim.” *Id.* Indeed, the *CoServ* court specifically noted that the preplan satisfaction of prepetition claims would be a valid exercise of the debtor’s fiduciary duty when the payment “is the only means to effect a substantial enhancement of the estate” *Id.*

51. Consistent with a debtor’s fiduciary duties, where there is a sound business purpose for the payment of prepetition obligations, and where the debtor is able to “articulate some business justification, other than the mere appeasement of major creditors,” courts have authorized debtors to make such payments under section 363(b) of the Bankruptcy Code. *See, e.g., In re Ionosphere Clubs, Inc.*, 98 B.R. at 175 (finding that a sound business justification existed to pay prepetition wages); *In re James A. Phillips, Inc.*, 29 B.R. at 397 (relying upon section 363 as a basis to allow a contractor to pay the prepetition claims of suppliers who were potential lien claimants).⁸

52. In addition to the authority granted a debtor in possession under sections 1107(a), 1108, 363(b) and 105(a) of the Bankruptcy Code, courts have developed the “doctrine of necessity” or the “necessity of payment” rule, which originated in the landmark case of

⁸ Courts have also authorized payment of prepetition claims in appropriate circumstances pursuant to section 105(a) of the Bankruptcy Code. Section 105(a) of the Bankruptcy Code, which codifies the inherent equitable powers of the bankruptcy court, empowers the bankruptcy court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). Under section 105(a), courts may permit preplan payments of prepetition obligations when such payments are essential to the continued operation of the debtor’s business and, in particular, where nonpayment of a prepetition obligation would trigger a withholding of goods or services essential to the debtors’ business reorganization plan. *See In re UNR Indus.*, 143 B.R. 506, 520 (Bankr. N.D. Ill. 1992) (permitting the debtor to pay prepetition claims of suppliers or employees whose continued cooperation is essential to the debtors’ successful reorganization); *Ionosphere Clubs*, 98 B.R. at 177 (finding that section 105 empowers bankruptcy courts to authorize payment of prepetition debt when such payment is needed to facilitate the rehabilitation of the debtor).

Miltenberger v. Logansport, C. & S.W.R. Co., 106 U.S. 286 (1882). Since *Miltenberger*, courts have expanded their application of the doctrine of necessity to cover instances of a debtor's reorganization, see *Dudley v. Mealey*, 147 F.2d 268, 271 (2d Cir. 1945) (holding, in a hotel reorganization matter, that the court was not "helpless" to apply the rule to supply creditors where the alternative was the cessation of operations). The United States Court of Appeals for the Third Circuit which recognized the doctrine of necessity in *In re Lehigh & New England Ry. Co.*, 657 F.2d 570, 581 (3d Cir. 1981).

53. In *Lehigh*, the Third Circuit held that a court could authorize the payment of prepetition claims if such payment was essential to the continued operation of the debtor. *Id.* (stating that a court may authorize payment of prepetition claims when there "is the possibility that the creditor will employ an immediate economic sanction, failing such payment"); see also *In re Penn Cent. Transp. Co.*, 467 F.2d 100, 102 n.1 (3d Cir. 1972) (holding that the necessity of payment doctrine permits "immediate payment of claims of creditors where those creditors will not supply services or material essential to the conduct of the business until their pre-reorganization claims have been paid"); *In re Just for Feet, Inc.*, 242 B.R. at 824-45 (noting that debtors may pay prepetition claims that are essential to continued operation of the business); *In re Columbia Gas Sys., Inc.*, 171 B.R. 189, 191-92 (Bankr. D. Del. 1994) (same).

54. Today, the rationale for the necessity of payment rule – the rehabilitation of a debtor in reorganization cases – is "the paramount policy and goal of Chapter 11." *In re Ionosphere Clubs, Inc.*, 98 B.R. at 176; *Just For Feet*, 242 B.R. at 826 (finding that payment of prepetition claims to certain trade vendors was "essential to the survival of the debtor during the chapter 11 reorganization."); see also *In re Quality Interiors, Inc.*, 127 B.R. 391, 396 (Bankr. N.D. Ohio 1991) ("[P]ayment by a debtor-in-possession of pre-petition claims outside of a

confirmed plan of reorganization is generally prohibited by the Bankruptcy Code”, but “[a] general practice has developed . . . where bankruptcy courts permit the payment of certain pre-petition claims, pursuant to 11 U.S.C. § 105, where the debtor will be unable to reorganize without such payment.”); *In re Eagle-Picher Indus., Inc.*, 124 B.R. 1021, 1023 (Bankr. S.D. Ohio 1991) (approving payment of prepetition unsecured claims of tool makers as “necessary to avert a serious threat to the Chapter 11 process”); *Burchinal v. Cent. Wash. Bank (In re Adams Apple, Inc.)*, 829 F.2d 1484, 1490 (9th Cir. 1987) (finding that it is appropriate to provide for the “unequal treatment of pre-petition debts when [such treatment is] necessary for rehabilitation”); Collier on Bankruptcy P 105.02[4][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. rev.) (discussing cases in which courts have relied upon the “doctrine of necessity” or the “necessity of payment” rule to pay prepetition claims immediately).

55. Here, the relief requested herein will benefit the Debtors’ estates and creditors by allowing the Debtors’ business operations to continue without interruption. In the absence of such payments, the Debtors believe that their Employees and Independent Contractors may seek alternative employment opportunities, perhaps with the Debtors’ competitors. Such a development would deplete the Debtors’ workforce, hinder the Debtors’ ability to meet its customer obligations and likely diminish creditors’ confidence in the Debtors. Moreover, the loss of valuable individuals and the recruiting efforts that would be required to replace them would be a massive and costly distraction at a time when the Debtors should be focusing on stabilizing their operations.

56. The importance of a debtor’s employees to its operations has been recognized by courts in this district in granting relief similar to the relief requested herein. Indeed, courts in this jurisdiction have approved relief similar to the relief requested in this motion. *See, e.g., In re*

School Specialty, Inc., No. 13-10125 (KJC) (Bankr D. Del. Jan. 30, 2013) (stating that relief requested is in the “best interests of the Debtors”); *In re THQ, Inc.*, No. 12-13398 (MFW) (Bankr. D. Del. Dec. 20, 2012) (same); *In re Vertis Holdings, Inc.*, No. 12-12821 (CSS) (Bankr. D. Del. Nov. 1, 2012) (same); *In re A123 Systems, Inc.*, Case No. 12-12859 (KJC) (Bankr D. Del. Oct. 18, 2012) (same); *In re Neb. Book Co.*, No. 11-12005 (PJW) (Bankr. D. Del. July 21, 2011) (same).⁹

C. Cause Exists to Authorize the Debtors’ Financial Institutions to Honor Checks and Electronic Fund Transfers

57. The Debtors represent that they have sufficient availability of funds to pay the amounts described herein in the ordinary course of business by virtue of cash reserves, expected cash flows from ongoing business operations and anticipated access to debtor in possession financing. Also, under the Debtors’ existing cash management system, the Debtors represent that checks or wire transfer requests can be readily identified as relating to an authorized payment made to an Employee. Accordingly, the Debtors believe that checks or wire transfer requests, other than those relating to authorized payments, will not be honored inadvertently and that all applicable financial institutions should be authorized, when requested by the Debtors, to receive, process, honor and pay any and all checks or wire transfer requests in respect of the Employee Obligations.

The Requirements of Bankruptcy Rule 6003 are Satisfied

58. As described above, the Debtors are seeking authority pursuant to the Interim Order to pay certain of the Employee Obligations during the first 21 days of these chapter 11

⁹ Because of the voluminous nature of the orders cited herein, such orders are not attached to this motion. Copies of these orders are available upon request to the Debtors’ counsel.

cases. Under Bankruptcy Rule 6003, the Court may authorize the Debtors to satisfy the payment of the Employee Obligations within the 21-day period after the Petition Date because such relief is necessary to avoid immediate and irreparable harm to the Debtors' estates. *See* Fed. R. Bankr. Proc. 6003(b). Immediate and irreparable harm exists where the absence of relief would impair a debtor's ability to reorganize or threaten the debtor's future as a going concern. *See In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 36 n.2 (Bankr. S.D.N.Y. 1990) (discussing the elements of "immediate and irreparable harm" in relation to Bankruptcy Rule 4001).

59. The Debtors' Employees are integral to their operations. Failure to satisfy obligations to Employees in the ordinary course of business will jeopardize Employee loyalty and trust, possibly causing Employees to leave the Debtors' employ and thereby disrupting the Debtors' operations to the detriment of all parties in interest. Moreover, the Debtors' Employees rely on the Debtors' timely payment of their compensation and provision of benefits. Accordingly, the Debtors respectfully submit that they have satisfied the "immediate and irreparable harm" standard of Bankruptcy Rule 6003 and seek authority to pay the Employee Obligations described herein pursuant to the Interim Order.

Waiver of Bankruptcy Rules Regarding Notice and Stay of an Order

60. To implement the foregoing successfully, the debtors seek a waiver of the notice requirements under Bankruptcy Rule 6004(a) and any stay of an order granting the relief requested herein pursuant to Bankruptcy Rule 6004(h), 7062, 9014 or otherwise.

The Debtors' Reservation of Rights

61. Nothing contained herein is intended or should be construed as an admission as to the validity of any claim against the Debtors, a waiver of the Debtors' rights to dispute any claim or an approval or assumption of any agreement, contract or lease under section 365 of the

Bankruptcy Code. The Debtors expressly reserve their rights to contest any Employee Obligation. Likewise, if this Court grants the relief sought herein, any payment made pursuant to the Court's order is not intended and should not be construed as an admission as to the validity of any claim or a waiver of the Debtors' rights to subsequently dispute such claim.

Notice

62. The Debtors have provided notice of this motion to: (a) the Office of the United States Trustee for the District of Delaware; (b) the entities listed on the Consolidated List of Creditors Holding the 30 Largest Unsecured Claims filed pursuant to Bankruptcy Rule 1007(d); (c) counsel to the Debtors' prepetition secured lender and debtor in possession lender; (d) the agent for the Debtors' prepetition secured notes; (e) counsel to each of the prepetition equity holders; (f) the Delaware Secretary of State; (g) the Delaware Secretary of Treasury; (h) the Delaware State Attorney General; (i) the Office of the United States Attorney General for the State of Delaware; (j) the Internal Revenue Service; and (k) the Securities and Exchange Commission. In light of the nature of the relief requested in this motion, the Debtors respectfully submit that no further notice is necessary.

No Prior Request

63. No prior motion for the relief requested herein has been made to this or any other court.

[Remainder of page intentionally left blank.]

WHEREFORE, for the reasons set forth herein and the First Day Declaration, the Debtors respectfully request that the Court enter the Interim Order and the Final Order, substantially in the forms attached hereto as Exhibit A and Exhibit B, respectively, (a) authorizing, but not directing, the Debtors to pay prepetition wages, salaries, other compensation and reimbursable employee expenses, (b) authorizing, but not directing, the Debtors to continue employee benefits programs, (c) authorizing financial institutions to receive, process, honor and pay all related checks and electronic payment requests for payment of prepetition Employee Obligations, (d) scheduling a Final Hearing to consider entry of the Final Order (to the extent a Final Hearing is necessary) and (e) granting such other and further relief as may be appropriate.

Dated: February 28, 2013
Wilmington, Delaware

/s/ Domenic E. Pacitti

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