UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

---	x	
In re:	:	
	:	Case No. 06-51848
CEP HOLDINGS, LLC, et al.,[1]	:	(Jointly Administered)
	:	
Debtors.	:	Chapter 11
	:	
	:	Honorable Marilyn Shea-Stonum
	:	
---	x	

CONSOLIDATED REPLY TO OBJECTIONS TO THE MOTION OF DEBTORS AND DEBTORS IN POSSESSION, PURSUANT TO SECTIONS 105(a), 363(b) AND 503(c)(3) OF THE BANKRUPTCY CODE, FOR ENTRY OF AN ORDER AUTHORIZING THEM TO ADOPT A PERFORMANCE BONUS PLAN AND MAKE PAYMENTS THEREUNDER

CEP Holdings, LLC and its affiliated debtors and debtors in possession (each a "**Debtor**" and collectively, the "**Debtors**" or "**CEP**") in the above-captioned Chapter 11 cases (the "**Cases**"), hereby file this consolidated reply (the "**Reply**") to the objections (collectively, the "**Objections**") filed by certain parties (collectively, the "**Objectors**")[2] to the *Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b) and 503(c)(3) of the Bankruptcy Code, for Entry of an Order Authorizing Them to Adopt a Performance Bonus Plan and Make Payments Thereunder* (Docket No. 97) (the "**Motion**")[3] on October 20, 2006. In support of this Reply and the Motion, the Debtors respectfully represent as follows:

---

[1] The Debtors are: CEP Holdings, LLC, Creative Engineered Polymer Products, LLC and Thermoplastics Acquisition, LLC.

[2] The Objectors are: Official Committee of Unsecured Creditors (the "**Committee**"), United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (the "**USW**"), and Fabnet Associates, Inc., Norris Sales Associates, Inc. and C.H. Raches, Inc. (collectively, the "**Independent Contractors**").

[3] Capitalized terms not otherwise defined herein have the meanings given to them in the Motion.

PRELIMINARY STATEMENT

The Objectors challenge the Debtors' adoption of a Performance Bonus Plan that is primarily funded by the Customers with assets that are not available for distribution to unsecured creditors in these Cases. As the Debtors will show at the hearing scheduled before the Court on October 24, 2006, the adoption of the Performance Bonus Plan is necessary to prevent irreparable harm to the Debtors' estates and is warranted under the facts and circumstances of these Cases. Accordingly, for the reasons set forth herein and in the Motion, the Objections should be overruled and the Debtors' adoption Performance Bonus Plan should be approved.

BACKGROUND

General Background

1. On September 20, 2006, each Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Pursuant to an order entered by the Court on September 26, 2006, the Cases are being jointly administered for procedural purposes only.

2. The Debtors are operating their businesses as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. On September 28, 2006, the United States Trustee appointed the Committee. No trustee or examiner has been appointed.

The Incentive Plan Motion

3. On October 3, 2006, the Debtors filed the Motion seeking authority to adopt the Performance Bonus Plan. As set forth in the Motion, the Debtors believe that the Performance Bonus Plan is necessary to maintain employee morale and fairly compensate employees, many of whom have been working overtime and on the weekends in order meet production demands without any additional compensation. Accordingly, the Debtors believe that the adoption of the Performance Bonus Plan is warranted under sections 105(a), 363(b) and 503(c)(3) of the Bankruptcy Code and applicable case law.

The Objections

4. On October 20, 2006, the Objectors filed the following Objections to the Motion:

a. *Objection to the Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b) and 503(c)(3) of the Bankruptcy Code, for Entry of an Order Authorizing Them to Adopt a Performance Bonus Plan and Make Payments Thereunder* (Docket No. 165) (the "**Committee Objection**");

b. *Objection of United Steelworkers to Debtors' Motion for Authorization to Adopt a Performance Bonus Plan and Make Payments Thereunder* (Docket No. 168) (the "**USW Objection**"); and

c. *Objection of Independent Contractors to Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b) of the Bankruptcy Code, for Entry of an Order Authorizing Them to Adopt a Performance Bonus Plan and Make Payments Thereunder* (Docket No. 170) (the "**Independent Contractor Objection**").

5. By the Objections, the Objectors make the following arguments and assertions in opposition to the Debtors' adoption of the Performance Bonus Plan:

a. The Debtors' adoption of the Performance Bonus Plan is not necessary because the Bonus Periods both end on or before October 31, 2006 (Committee Objection at ¶ 15);

b. The Performance Bonus Plan violates section 503(c) of the Bankruptcy Code because the Performance Bonus Plan benefits insiders (Committee Objection at ¶¶ 23-24; USW Objection at ¶ 10);

c. Management has the ability to manipulate the Normal Plant Percentage factor to preserve and maximize the Bonus Period Potential Award for certain Covered Employees (Committee Objection at ¶ 18);

d. The Performance Bonus Plan violates section 503(c)(2) of the Bankruptcy Code because payments made under the Performance Bonus Plan could be satisfied as severance payments (Committee Objection at ¶ 21);

e. The Performance Bonus Plan violates section 503(c)(2) of the Bankruptcy Code because certain bonuses payable under the Performance Bonus Plan are discretionary (Committee Objection at ¶ 18);

f. The Performance Bonus Plan violates section 503(c)(1) of the Bankruptcy Code because covered employees that quit during a Bonus Period forfeit any bonus earned during that period (USW Objection at ¶ 11);

g. The Performance Bonus Plan violates section 503(c)(1) of the Bankruptcy Code because the Performance Bonus Plan has a retentive effect (USW Objection at ¶ 14);

h. The Performance Bonus Plan violates section 503(c)(3) of the Bankruptcy Code because the Performance Bonus Plan is not warranted under the circumstances because it does not encourage performance beyond what is expected and because it will negatively impact the morale of union employees (USW Objection at ¶¶ 16-18); and

i. The Performance Bonus Plan should not be approved unless and until the Independent Contractors are paid all amounts due and owing to them as of the Petition Date (Independent Contractor Objection at ¶ 5).

6. For the reasons set forth herein and in the Motion, each of these arguments should be rejected, the Motion should be granted and the adoption of the Performance Bonus Plan should be approved in all respects.

ARGUMENT

A. The Objectors Lack Standing to Object to the Performance Bonus Plan to the Extent that it Is Funded by the Customers

7. As an initial matter, the Objectors lack standing to object to the Debtors' adoption of the Performance Bonus Plan to the extent that the Performance Bonus Plan is funded by cash infusions from the Customers.

8. As a general rule, third parties like the Objectors do not have standing to object to motions or proposed orders when such parties do not have a direct and pecuniary interest in the outcome of the proceeding. *See*, *e.g.*, *In re Wonder Corp. of Am.*, 70 B.R. 1018, 1023 (Bankr. D. Conn. 1987) (holding that third parties in interest only have standing to object when the proposed order will have a direct and adverse pecuniary affect and stating "courts generally will only hear arguments of parties who have a direct stake in the consequences of a proceeding"); *In re Johns-Manville Corp.*, 68 B.R. 618, 624 (Bankr. S.D.N.Y. 1986) (same), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988); *see also Kane v. Johns-Manville Corp.*, 843 F.2d 636,

644 (2d Cir. 1988) ("The prudential concerns limiting third-party standing are particularly relevant in the bankruptcy context."); *In re Orlando Investors, L.P.*, 103 B.R. 593, 597 (Bankr. E.D. Pa. 1989) (holding that "traditional standing concepts" are applicable in chapter 11 proceedings).

9. Under traditional standing principles, the Objectors do not have standing to object to the Debtors' adoption of the Performance Bonus Plan to the extent that it is funded by cash infusions from the Customers.. Indeed, it is possible that the Performance Bonus Plan will be funded entirely by cash infusions from the Customers. The cash infusions provided by the Customers are not assets that are available for distribution to unsecured creditors or any of the Objectors. Thus, to the extent that the Performance Bonus Plan is being funded by cash infusions, the Objectors cannot be harmed pecuniarily and, in fact, only stand to benefit from the increased productivity that has and will result from the Debtors' adoption of the Performance Bonus Plan. Accordingly, to the extent that the Performance Bonus Plan is funded by cash infusions from the Customers, the Objectors lack standing to object to the Debtors' adoption of the Performance Bonus Plan.

10. The only pecuniary interest that the Objectors have in this matter is contingent upon a *de minimis* portion of the funding for the Performance Bonus Plan being postpetition debt. The Debtors do not dispute that the Objectors have standing to object to the Debtors' adoption of the Performance Bonus Plan to the extent that a *de minimis* portion of the funding for the Performance Bonus Plan is postpetition debt. For the reasons set forth in the Motion and in this Reply, however, the Debtors believe that the harm that will be caused by the failure of the Debtors to adopt the Performance Bonus Plan substantially outweighs the potential for harm, if any, to the Objectors.

B. The Debtors' Employees Are Relying on the Performance Bonus Plan

11. Contemporaneously with the filing of the Motion, the Debtors sent a letter to every Covered Employee informing them of the Debtors' efforts to adopt the Performance Bonus Plan. This letter clearly indicates that the Debtors' adoption of the Performance Bonus Plan is dependent upon Court approval. The Covered Employees, however, know that the Performance Bonus Plan has been agreed to by the Debtors, the Customers and Wachovia. Thus, the Debtors, believe that many of the Covered Employees have remained with the Debtors since the Petition Date in reliance upon the Performance Bonus Plan.

12. Accordingly, while both Bonus Periods end on or before October 31, 2006, the Performance Bonus Plan has and will continue to motivate the Covered Employees and increase the value of the Debtors' assets. It would be unjust for the Debtors and other parties in interest to benefit from the proposed adoption of the Performance Bonus Plan without honoring the obligations arising thereunder. In effect, the Committee seeks to benefit from the proposal of the Performance Bonus Plan without having any of the obligations arising thereunder actually fulfilled. This is simply unacceptable.

13. Further, the Committee Objection ignores the potentially devastating impact that failing to honor the obligations arising under the Performance Bonus Plan would have on the morale of the Covered Employees that have relied upon the proposed adoption of the Performance Bonus Plan. Indeed, many of the Covered Employees already have other job offers and will be leaving the Debtors within the next month. If the Performance Bonus Plan is not approved, the Debtors believe that most, if not all, of the Covered Employees will feel betrayed and will not show up for work, opting instead to use vacation time before starting their new jobs. If this occurs, the Debtors will have to consider converting the Cases to chapter 7. This would have a substantial and negative impact on the Debtors' estates and all parties in interest.

C. The Performance Bonus Plan Does Not Unfairly Favor Insiders

14. The Performance Bonus Plan is not one that primarily rewards insiders. By the Committee's own admission, only 19% of the proposed bonus funds are payable to the Tier 1A Group. *See* Committee Objection at ¶ 23. The remaining 81% is payable to non-insiders that are essential to the Debtors' operations and cannot be replaced given the exigencies of the Debtors' bankruptcy and pending liquidation. The disparity between the amount payable to the Tier 1A Group and the other Covered Employees is hardly significant given the difference in salary and other forms of compensation that typically exist between these employees. Accordingly, the Performance Bonus Plan is not one that primarily rewards or benefits insiders.

D. Management Cannot Arbitrarily Determine the Normal Plant Percentage Factor

15. Management cannot arbitrarily determine the Normal Plant Percentage factor. The bonuses of certain company-wide employees are not based solely on the performance of one facility. Rather, the bonuses of these employees are based on a percentage of production at all of the Covered Plants. Accordingly, under the Performance Bonus Plan, each Covered Plant is assigned a percentage, defined as the Normal Plant Percentage, which in the opinion of management "reasonably represents the percentage of production normally represented or to be reasonably expected by that plant, out of the total production of all Covered Plants." Performance Bonus Plan at § 6(d).

16. As set forth in the Performance Bonus Plan, the Normal Plant Percentage is not subject to manipulation by management to maximize the bonuses of the company-wide employees. Rather, the Normal Plant Percentage for each Covered Plant must be reasonably related to the historical production at Covered Plant as compared to the historical production at all Covered Plants. This is an objective measure and not a subjective one. Thus, the

Committee's assertion that "management can manipulate at its sole discretion the Normal Plant Percentage factor . . . without regard to facility performance" is factually not true.

E. <u>The Performance Bonus Plan Is Not a Severance Plan</u>

17. Section 503(c)(2) of the Bankruptcy Code is not implicated by the proposed payments to insiders under the Performance Bonus Plan because the payments are not "severance payments."

18. Severance pay is earned when an employee is terminated and, therefore, is compensation for termination as opposed to a form of wages. *See In re Cincinnati Cordage and Paper Co.*, 271 B.R. 264, 269 (Bankr. S.D. Ohio 2001) ("A claim for severance pay is a claim for damages resulting from the termination of an employment contract."); *accord Trs. of the Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 104 (2d Cir. 1986) (recognizing that severance pay is "earned" when an employee is dismissed); *In re W.T. Grant Co.*, 620 F.2d 319, 321 (2d Cir. 1980) ("[S]everance pay is not earned from day to day and unlike wages does not accrue. . . . [O]ur decision turned on our definition of severance pay as compensation for termination, as opposed to a form of wages that accrues from day to day.").

19. No bonus payable under the Performance Bonus Plan is earned when a Covered Employee is terminated. In fact, a Covered Employee that quits before the expiration of a Bonus Period is not eligible for a bonus for that period. Contrary to the USW Objection, this feature not only makes good business sense, but arguably is required in order for the Performance Bonus Plan to avoid running afoul of section 503(c)(2) of the Bankruptcy Code. The fact that certain bonus amounts are determined by management does not support the Objections. None of the proposed payments under the Performance Bonus Plan can properly be fairly characterized as severance. Accordingly, the Performance Bonus Plan does not violate section 503(c)(2) of the Bankruptcy Code.

F. **The Performance Bonus Plan Is Not a Retention Plan**

20. Just because the Performance Bonus Plan may have some retentive effect does not mean that the Performance Bonus Plan is a retention plan within the scope of section 503(c)(1) of the Bankruptcy Code. *See In re Dana Corp.*, No. 06-10354, 2006 Bankr. LEXIS 2181, at *16 (Bankr. S.D.N.Y. Sept. 5, 2006) ("I do not find that incentivizing plans which may have *some* components that arguably have a retentive effect, necessarily violation section 503(c)'s requirements.") (emphasis in original). Indeed, any incentive plan will have some retentive effect.

21. The Performance Bonus Plan is an incentive plan that does not reward mere retention. As set forth in the Motion, the Performance Bonus Plan rewards employees for performance tied directly to critical restructuring and output goals for the purpose of preserving the value of the Debtors' estates and does not provide compensation for mere continued employment. The failure to meet the requisite restructuring and output goals is fatal to a Covered Employee's right to a bonus under the Performance Bonus Plan.

22. The fact that the Performance Bonus Plan benefits certain company-wide employees does not support the Objections. Company-wide employees provide assistance and service to various aspects of the Debtors' businesses and, therefore, play a key role in the production process of multiple manufacturing facilities. Accordingly, it is appropriate to tie the bonus of these employees to the output of multiple facilities and not one or none of the Debtors' facilities.

23. Finally, the USW's assertion that meeting a production schedule amidst the ongoing and pending liquidation of the Debtors' businesses is somehow "relatively easy" is misplaced. *See* USW Objection at ¶ 13. Most, if not all, of the Debtors' employees are now aware that the Debtors' facilities are shutting down or will be sold as going concerns pursuant to

section 363 of the Bankruptcy Code. Many are seeking employment elsewhere and are distracted by the reality that they will soon be out of work. Meeting production goals in this environment is extremely difficult. Indeed, many of the Covered Employees have been working overtime and on the weekends without any additional pay. Accordingly, it is appropriate and necessary for the Debtors to adopt the Performance Bonus Plan to reward collective effort during these times and to maximize and preserve the Debtors' assets for the benefit of all parties in interest.

24. In sum, while the Performance Bonus Plan is not a retention plan within the scope of section 503(c)(1) of the Bankruptcy Code because it does not reward mere retention, the retentative effects of the Performance Bonus Plan are an inevitable by-product. Indeed, any incentive plan will have some retentative effect. Given the exigencies of the circumstances, the retentative aspect of the Performance Plan further justifies its adoption rather than substantiate the USW's concerns.

G. The Performance Bonus Plan Is Warranted by the Facts and Circumstances of These Cases

25. The Performance Bonus Plan is warranted by the facts and circumstances of these Cases. As set forth above, the adoption of the Performance Bonus Plan is necessary to maintain production at the levels normally expected at the Debtors' manufacturing facilities and to preserve the value of the Debtors' assets for the benefit of all parties in interest. The Debtors intend on producing evidence to this effect at the hearing scheduled before the Court on October 24, 2006.

26. The Debtors appreciate the cooperation of the USW at the Debtors' facilities in Canton and Crestline. The Debtors believe that the union employees at these facilities have provided a valuable contribution to the Debtors' restructuring efforts. The Debtors, however,

took this contribution into account when they negotiated the terms of the Performance Bonus Plan with the Customers and Wachovia. Because the union employees receive overtime, and certain Covered Employees, including the plant managers that have been working overtime and on the weekends to meet production demands, do not, the Debtors, in their business judgment, have decided not to further reward the union employees under the Performance Bonus Plan. Accordingly, the Debtors believe that the inclusion of the union employees under the Performance Bonus Plan is not warranted under the facts and circumstances of these Cases.

H. The Independent Contractors Are Not Needed

27. Finally, the Independent Contractors' assertion that the approval of the Performance Bonus Plan should in any way be affected by the payment of prepetition claims to the Independent Contractors is absurd. At this time, the Independent Contractors no longer are needed by the Debtors. Accordingly, there is no legitimate business justification for paying them amounts due and owing as of the Petition Date under sections 105(a) or 363(b) of the Bankruptcy Code.[4] The Independent Contractors decision to intervene in this matter is misplaced.

[4] The Debtors have withdrawn the *Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b), 507(a)(4), 507(a)(5) and 541(d) of the Bankruptcy Code, for Entry of an Order (I) Authorizing them to Pay: (A) Prepetition Employee and Independent Contractor Wages, Salaries and Related Items; (B) Prepetition Employee and Independent Contractor Business Expenses; (C) Prepetition Contributions to and Benefits Under Employee Benefit Plans; (D) Prepetition Employee Payroll Deductions and Withholdings; (E) Additional Workforce Costs and (F) All Costs and Expenses Incident to the Foregoing Payments and Contributions; and (Ii) Granting Certain Related Relief* (Docket No. 8) to the extent that it seeks the payment of prepetition claims to the Independent Contractors.

CONCLUSION

For the reasons set forth herein and in the Motion, the Motion should be granted and the adoption of the Performance Bonus Plan should be approved in all respects.

Dated: October 23, 2006
Cleveland, OH

CEP HOLDINGS, LLC, et al.,
Debtors and Debtors-in-possession

By: /s/ Joseph F. Hutchinson, Jr.
One of Their Attorneys

Joseph F. Hutchinson, Jr. (0018210)
Thomas M. Wearsch (0078403)
Eric R. Goodman (0076035)
BAKER & HOSTETLER LLP
3200 National City Center
1900 East 9th Street
Cleveland, Ohio 44114-3485
Phone: 216.621.0200
Fax: 216.696.0740

Counsel for the Debtors and Debtors-in-Possession