

Date signed February 25, 2010



James F. Schneider
JAMES F. SCHNEIDER
U. S. BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND

In re: *

FIELDSTONE MORTGAGE CO., *

Case No. 07-21814-JS

Debtor *

Chapter 11

* * * * *

***MEMORANDUM OPINION DENYING MOTION TO AUTHORIZE DEBTOR
TO MAKE KEY EMPLOYEE RETENTION PAYMENTS
[ON REMAND FROM THE UNITED STATES DISTRICT COURT]***

Before the Court is the motion of the Chapter 11 debtor to authorize key employee retention payments (“KERP”) to seven employees. This matter came on for hearing upon remand from the United States District Court for the District of Maryland (Blake, D.J.). Having been found to be officers of the debtor, and therefore insiders, the issue on remand is whether any of the seven employees are able to satisfy the limitations set forth in Section 503(c)(1) in order to receive payments under the

KERP.¹ For the following reasons, this opinion holds that the limitations have not been met and therefore the debtor's motion will be denied.

FINDINGS OF FACT

1. "Fieldstone Mortgage Company ("Fieldstone"), the debtor in this case, was a national mortgage banking company that originated and sold conforming and non-conforming residential mortgage loans secured by residential real estate. In 2006, it originated approximately \$5.5 billion of mortgage loans. As of July 31, 2007, it had about 1,200 employees. Due to problems in the mortgage market that became apparent in 2006, Fieldstone faced increasing liquidity difficulties, and ultimately had to file for Chapter 11 bankruptcy. At the time it filed for bankruptcy, November 23, 2007, its workforce had been reduced to about 50-60 employees." *Office of U.S. Trustee v. Fieldstone Mortg. Co.*, 2008 WL 4826291 at *1.

¹This Court is bound by Judge Blake's finding that the seven employees for whom the KERP payments were intended are officers, and therefore insiders, regardless of the view that, "When everyone is somebody, then no one's anybody." William S. Gilbert, "There Lived a King," from *The Gondoliers* (1889). In bankruptcy, this view does not prevail "when everyone is a vice president." *See. e.g., In re Foothills Texas, Inc.*, 408 B.R. 573, 584 (Bankr. D. Del. 2009) (Vice presidents of debtor corporation failed to rebut the presumption that they were officers and therefore "statutory insiders.") In her opinion, Judge Blake noted that "Fieldstone at one point employed approximately 60 persons with the title Vice President," citing the debtor's Statement of Financial Affairs. *Id.*, fn. 10. All seven employees were reported by Fieldstone as officers and were also listed as insiders in the debtor's Statement of Financial Affairs. All seven were board-appointed officers who exercised control over various facets of Fieldstone's corporate operations.

2. On January 10, 2008, Fieldstone filed the instant motion, entitled “Motion for Order Authorizing Debtor to Implement Employee Incentive Plan Pursuant to Sections 105, 363 and 503 of the Bankruptcy Code” [P. 121], in which it requested authority to implement an employee incentive plan for 23 of its remaining employees. Despite the pleading’s title, the body of the motion referred to “the need for the retention program,” the purpose of which was to permit the debtor to pay bonuses to certain valued employees to retain their continuing services during the pendency of the instant Chapter 11 bankruptcy case in order to facilitate its reorganization.

3. The motion contained the following averment:

As the debtor dealt with its liquidity crisis and the eventual filing of its bankruptcy case, it devised a retention program that it believed necessary to retain and incentivize employees needed to maintain the operations of the Debtor. In preparation for the filing of its case the Debtor negotiated a Post-Petition Loan and Security Agreement (the “DIP Loan”) with C-Bass. As part of the DIP Loan and the budget appended thereto, certain portions of the payments needed to fund the retention program were provided for. ***Thus, the retention program and certain funding for it have been approved.*** The Debtor now files this motion, out of an abundance of caution, to obtain final approval of the retention program.

Motion, Paragraph 9 [emphasis supplied].

4. The Office of the United States Trustee opposed the motion and argued that because some of the employees affected by the KERP were officers, they were

“insiders” pursuant to Section 101(31)(B) of the Bankruptcy Code,² subject to the conditions set forth in Section 503(c)(1).³

²Section 101(31)(B) provides as follows:

(31) 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)(B).

³Section 503(c) provides as follows:

§ 503. Allowance of administrative expenses.

(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid–

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor’s business, absent a finding by the court based on evidence in the record that–

5. In response to the objection, Fieldstone reduced the number of retained employees to the following seven, each of whom was a management person in charge of his or her department:

(1) Jennifer Bliden, Vice President of Systems, who was responsible for all of the computing systems at Fieldstone and maintenance of its firewalls;

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred[.]

11 U.S.C. § 503(c)(1).

(2) Thomas Brennan, Vice President and Acting General Counsel, who reviewed all of the legal documentation generated by and for Fieldstone and helped to oversee Fieldstone litigation across the country;

(3) John Camp, Senior Vice President and Chief Information Officer, whose duties included the protection of data involving \$12 million in investments;⁴

(4) Nancy Maradie, Vice President and Assistant Secretary Treasurer, who paid all vendors and employees of Fieldstone and managed its cash;

(5) Theresa McDermott, Senior Vice President and Controller, who reported requirements for the company such as SOFA;

(6) Jacqueline Smith (now Malone), Vice President of Licensing, who maintained all of Fieldstone's licensing to buy and sell mortgages and surety bonds in all 50 states; and

(7) William Wolfe, Vice President of Facilities, who provided and maintained equipment for over 90 Fieldstone offices across the country.

6. Fieldstone argued that the seven employees were essential to the debtor's successful completion of this Chapter 11 case because of their expertise and

⁴The U.S. Trustee withdrew his objection to the KERP as to Messrs. Brennan and Camp, because they each received a *bona fide* competing job offer at the time the retention motion was filed. Both accepted the offers and are no longer employed by the debtor. Line Withdrawing Objection [P. 1377] filed July 17, 2009.

institutional knowledge and that the failure to retain them would result in substantial delay in the Chapter 11 process and increase the debtor's administrative expenses. The debtor alleged that it would be far more expensive to engage outside services and contractors to conduct the same services than to retain the existing employees.

7. The proposed KERP treats all remaining employees the same and is multiplied against each retained employee's respective salary to arrive at the incentive numbers. Affected employees can receive a bonus equal to two months' salary for as long as they remain in the debtor's employ.

8. On February 20, 2008, this Court heard arguments on the motion and held that the bonuses were permissible because the seven key employees were not officers in the traditional sense and therefore were not insiders under § 503(c)(1). The motion was approved by order [P. 259] entered on February 27, 2008. The U.S. Trustee appealed the decision.

9. On appeal, the U.S. District Court reversed.⁵ In her memorandum opinion and order [PP. 1127 and 1128] dated November 5, 2008, Judge Catherine C. Blake found that the employees were indeed officers and therefore were insiders, prohibited from receiving retention bonuses unless certain specific conditions were satisfied.

⁵This matter was remanded by amended order [P. 1144] dated November 21, 2008.

10. Judge Blake based her decision on the following factors: (1) each officer was appointed by the board of directors and (2) their titles, duties and identification as officers and insiders were specified in the company's bankruptcy filings.⁶

⁶*See, contra, In re CEP Holdings, LLC*, 2006 WL 3422665 (Bankr. N.D. Ohio 2006) (because title is not determinative of whether an employee is an officer, opinion approved bonus plan, holding that vice presidents and chief financial officer were not officers for purposes of Section 503(c)); *NMI Systems, Inc. v. Pillard (In re NMI Systems, Inc.)*, 179 B.R. 357 (Bankr. D. D.C. 1995) (“seminal case” defining “officer” under Section 101(31), holding that debtor’s vice president was not an officer on the sole basis of his title, and therefore not an insider for purposes of recovering a preference.). In *NMI*, Judge S. Martin Teel stated that “the appropriate test for whether [the defendant] was an officer is whether [he] occupied a high position within the corporation making him active in setting overall corporate policy or performing other important executive duties of such a character that it is likely that he would be accorded less than arms-length treatment in the payment of his antecedent claim against the debtor. The term ‘officer’ obviously includes anyone holding a position in which that person controls the decision whether to pay an antecedent claim. But it is broader and includes, for example, those in the collective group exercising overall authority regarding the debtor’s corporate decisions who, as members of that insider group, are in a position to exert undue influence over corporate decisions regarding payment of their claims in tight financial times including those who are privy to critical information regarding the debtor’s financial stability and able to act to their advantage on the basis of such information.” 179 B.R. at 369-70. *See also, Smith v. Ruby (In re Public Access Technology.com, Inc.)*, 307 B.R. 500 (E.D. Va. 2004) (whether a former owner of company that merged with debtor who had been given title of executive vice president was an officer of the debtor for purposes of recovering preference was a genuine issue of material fact that precluded granting summary judgment); and *Principal Mutual Life Insurance Co. v. Lakeside Associates, L.P. (In re DeLuca)*, 194 B.R. 797, 803 (Bankr. E.D. Va. 1996) (“In order to qualify under the rubric of being ‘in control of the debtor’, the alleged insider ‘must exercise sufficient authority over the debtor so as to unqualifiably dictate corporate policy and the disposition of corporate assets,’ ” citing *Butler v. David Shaw, Inc.*, 72 F.3d 437, 443 (4th Cir.1996).

11. In support of her legal conclusions, Judge Blake made the following factual findings:

With respect to the job responsibilities of these seven employees in particular, Mr. Sonnenfeld said that they were the heads of their respective departments. Ms. Bliden was responsible for all of the computing systems at Fieldstone (which was a computer-driven company) and the maintenance of its firewalls. Mr. Brennan, as acting general counsel, reviewed all of the legal documentation generated by and for Fieldstone. He also helped oversee Fieldstone litigation across the country. Mr. Camp's position required him to protect data involving \$12 million in investments. Ms. Maradie's position involved paying all vendors and employees of Fieldstone, and generally managing its cash. *Id.* Ms. McDermott performed all of the reporting requirements for the company, for instance its statements of financial affairs. Ms. Smith's position involved maintaining Fieldstone's licenses (to buy and sell mortgages) and surety bonds in all 50 states. Mr. Wolfe's position involved providing and maintaining equipment for over 90 Fieldstone offices across the country. Since Fieldstone has begun operating in bankruptcy, his position has involved selling Fieldstone's assets across the remaining offices, including negotiating court-approved asset sales. In short, Mr. Sonnenfeld's testimony demonstrated that each of the seven individuals were board-appointed officers who exercised extensive control over various facets of Fieldstone's corporate operations.

Id. (Citations and paragraph numbers omitted.)

12. Meanwhile, on July 14, 2008, the debtor's revised plan of reorganization [P. 826] was confirmed by order of this Court [P. 840], which resulted in a successful

sale of all of the debtor's stock to Planet Financial Group, LLC, ("Planet") a Delaware corporation, for a price of \$1.2 million.⁷

CONCLUSIONS OF LAW

1. Prior to BAPCPA,⁸ "it [was] common . . . for bankruptcy courts to approve the adoption of post-petition KERPs, or the assumption of pre-petition KERPS, if the debtor [had] used 'proper business judgment. . .'" *In re U.S. Airways, Inc.*, 329 B.R. 793, 797 (Bankr. E.D. Va. 2005).

2. However, "[r]ecently, Congressional concern over KERP excesses was clearly reflected in changes to the Bankruptcy Code that are effective for cases filed after October 17, 2005." *In re Dana Corp.*, 351 B.R. 96, 100 (Bankr. S.D. N.Y. 2006). *See* Hage and Mohan, "Recent Developments in Section 503 - Allowance of Administrative Expenses," 2009 NORTON ANNUAL SURVEY OF BANKRUPTCY LAW, 561-66.

⁷The question of whether the appeal of this matter to the United States District Court was equitably mooted by the confirmation and consummation of the debtor's plan during the pendency of the appeal was not raised by the -parties on remand. *Cf. Retired Pilots Assoc. of U.S. Airways, Inc. v. U.S. Airways Group, Inc. (In re U.S. Airways Group, Inc.)*, 369 F.3d 806 (4th Cir. 2004).

⁸The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 331, 119 Stat. 23, 102-03 (April 20, 2005).

3. Since BAPCPA went into effect, Section 503(c)(1) has provided stringent requirements that must be proven in order to obtain bankruptcy court approval of such plans. Accordingly, before this Court may approve KERP payments by a debtor in possession (in the form of a transfer or an obligation) to an insider for the purpose of retaining his or her employment during the pendency of the case, the Court must find from the evidence in the record that the debtor has satisfied the statutory requirements.⁹

4. The debtor as proponent of the KERP bears the burden of demonstrating that the proposed retention plan meets the requirements under § 503(c). *In re Global Home Products, LLC*, 369 B.R. 778, 785 (Bankr. D. Del. 2007) (“The statute makes it abundantly clear that in a post-BAPCA bankruptcy case, KERPs and severance arrangements subject to review under §503(c) – those whose purpose is to retain employees – are severely restricted.”).¹⁰

⁹Thus, Section 503(c)(1) is not an outright prohibition of the approval of a KERP, despite the extraordinary evidentiary burdens imposed by the statute.

¹⁰Despite these statutory strictures regarding KERPs, payments made to key employees pursuant to what were characterized as “incentive plans” have received court approval, even when the key employees were officers. *See, for example, In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D. N.Y. 2009), where the court approved an employee incentive plan provided for in a confirmed Chapter 11 plan as not violative of Section 503(c) because its purpose was not the retention of key employees; *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787 (Bankr. D. Del. 2007) (employee incentive plan for payment of bonuses to senior management was approved

5. The first requirement is that “the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business¹¹ at the same or greater rate of compensation.” Section 503(c)(1)(A). According to its plain meaning, this clause requires that unless the KERP is allowed to be proposed, a key employee will voluntarily leave the debtor’s employment because the employee has received a firm, good faith offer to work for a different employer for at least the same or greater compensation. Thus, the Court must evaluate

by bankruptcy court as complying with requirements of Section 503(c)). *But see In re Nellson Nutraceutical, Inc.*, 2008 WL 4532514 (D. Del. 2008), where the district court denied debtor/appellee’s motion to dismiss appeal on grounds of equitable and constitutional mootness where payments had already been made, holding that disgorgement of payments could nevertheless be granted if appeal were successful, despite appellant’s failure to obtain stay pending appeal; *Official Committee of Unsecured Creditors v. Airway Industries, Inc. (In re Airway Industries, Inc.)*, 354 B.R. 82, 87 n. 12 (Bankr. W.D. Pa. 2006) (incentive bonuses to insiders funded by secured creditor were not property of the estate subject to turnover and not prohibited by Section 503(c)); and *In re Nobex Corp.*, 2006 WL 4063024 (Bankr. D. Del. 2006) (“sale-related incentive pay” to senior managers is not governed by Section 503(c)(1) and (2) and not prohibited by Section 503(c)(3)). In a different context, *see In re Pilgrim’s Pride Corp.*, 401 B.R. 229 (Bankr. N.D. Tex. 2009) (holding that consulting, noncompetition agreements with former officers to prevent them from being employed by debtor’s competitors were not in the nature of retention agreements because officers would no longer be employed by the debtor). The debtor has not made a convincing argument that the payments made in the instant case were incentive as opposed to being strictly retentive in nature.

¹¹This Court interprets the phrase, “from another business,” to imply that the offer must come from a different business operation than that of the debtor.

(1) the employee's intention to leave unless the KERP is approved;¹² (2) whether the employee's reason for leaving is because the employee received a valid offer of employment from someone other than the debtor;¹³ and (3) whether the offer was at least as valuable or more valuable¹⁴ than that proposed by the KERP.¹⁵

6. At the first hearing before this Court, the debtor proved through the testimony of Mr. Sonnenfeld that these employees were essential to the business. He also testified that it would be more costly to retain outside services and contractors to conduct the same services that these employees perform.

¹²This requirement that the KERP was the *quid pro quo* for continuing to be employed by the debtor could be proven easily, on the key employee's own "say-so," except that the threat of leaving is tied to and made co-dependent upon a second cause, namely the receipt of another offer of employment from someone else.

¹³This clause would seem to indicate that the key employee is required to "shop the KERP around" in order to receive a KERP as a retained employee of a debtor in possession. For commentary critical of this provision, see Dorothy Hubbard Cornwell, *To Catch a Kerp: Devising A More Effective Regulation Than § 503(c)*, 25 EMORY BANKR. DEV. J. 485, 501-2 (2009).

¹⁴The phrase "greater rate of compensation" is superfluous if the purpose of the statutory requirement is that the proponent demonstrate that the amount of the KERP has been tested in the market and has thereby been objectively demonstrated to be fair and reasonable, namely the result of "arm's length" negotiation.

¹⁵In an unpublished opinion, Chief Judge Keir of this Court held that "stay bonuses" can be authorized to be paid if the services provided by the person are essential to the survival of the business and the employee received a *bona fide* job offer. *In re Chesapeake Knife and Tool Co., Inc.*, 2006 WL 4671820 (Bankr. D. Md. 2006).

7. The debtor has also presented evidence through the testimony of Ms. McDermott that the payments met the limitations in Section 503(c)(1)(C), namely that the payments are not greater than 10 times the amount of the mean transfer given to non-management employees for any purpose during the calendar year, or if no such similar transfers were made to such non-management employees during such calendar year, the amount of the payment is not greater than 25% of the amount of any similar transfer to such insider during the calendar year before the year in which such transfer is made. 11 U.S.C. § 503(c)(1)(C)(i).

8. Counsel for the debtor argued that the requirement of a *bona fide* job offer has been met because Planet, the purchaser of the debtor's stock under the confirmed plan, has agreed to offer the key employees the same compensation as that proposed by the KERP. While Planet is a different entity from the debtor, it would seem that the Planet offer was not from a different business, or in competition with the KERP, because as the purchaser of the debtor's business under the Plan, Planet's "business" is the same as that of the debtor. Planet merely agreed to match the KERP in order to ensure that key employees would continue to work for the reorganized debtor after the Planet takeover. As such, the Planet offer does not satisfy the statute's purpose of testing the value of the KERP as a competing offer. The failure to present such a competing offer forecloses the approval of the motion on remand.

9. The debtor has not explained the basis for its statement (quoted in Finding of Fact No. 3 from Paragraph 9 of the KERP motion [P. 121]) that court approval of the KERP was unnecessary because the Court already approved the payments contained in the budget in the DIP Loan. Contrary to the debtor's statement, in the opinion of this Court, the consent of the debtor-in-possession's lender to fund KERP payments did not excuse the debtor from complying with the specific requirements of the Bankruptcy Code.

ORDER ACCORDINGLY.

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motion pursuant to §§ 105¹, 363², and 503³ of the Bankruptcy Code (“Code”) on January 10, 2008, requesting implementation of an employee incentive plan – commonly referred to as a Key Employee Retention Plan or KERP – for 23 of its remaining employees, which would allow it to pay them bonuses (“KERP Motion”). After opposition from the U.S. Trustee, which argued that at least some of these employees were “insiders” under § 101(31)(B) of the Code⁴ and were

¹ Section 105 of the Code reads, in pertinent part: “The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11].” 11 U.S.C. § 105(a).

² Section 363 of the Code reads, in pertinent part: “The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1).

³ Section 503 of the Code, which pertains to KERPs, reads, in pertinent part:

[T]here shall neither be allowed, nor paid--

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor’s business, absent a finding by the court based on evidence in the record that--

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business

... .

11 U.S.C. § 503(c)(1).

⁴ Section 101(31)(B) of the Code offers the following definition of “insider”:

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)(B).

therefore barred from such retention payments under § 503(c)(1) of the Code, Fieldstone reduced the number to seven. These seven employees and their titles, as reported by Fieldstone, are as follows:

| | |
|---------------------------|--|
| Jennifer L. Bliden | Vice President ⁵ |
| Thomas S. Brennan | V.P. & Acting General Counsel ⁶ |
| John C. Camp | Sr. V.P. & Chief Information Officer |
| Nancy J. Maradie | V.P. & Assistant Secretary Treasurer |
| Teresa A. McDermott | Sr. V.P. & Controller |
| Jacqueline “Jacqui” Smith | Vice President ⁷ |
| William “Bill” L. Wolfe | Vice President ⁸ |

Fieldstone Statement of Financial Affairs (“Fieldstone SOFA”) at 9 & Ex. 23. In its SOFA, Fieldstone listed these names in response to Question 21(b), which states: “If the debtor is a corporation, list all officers and directors of the corporation, and each stockholder who directly or indirectly owns, controls, or holds 5 percent or more of the voting securities of the corporation.” Fieldstone SOFA at 9.⁹ All of these persons, then, were reported by Fieldstone to be officers, each holding a title of Vice President or above.¹⁰ These seven persons were also among those listed in response to Question 23 of the SOFA, which states: “If the debtor is a partnership or corporation, list all withdrawals or distributions credited or given to an insider . . .

⁵ Ms. Bliden was listed elsewhere as “VP, Systems.” Fieldstone SOFA at Ex. 23.

⁶ Mr. Brennan was listed elsewhere as “VP, Legal Counsel.” Fieldstone SOFA at Ex. 23.

⁷ Ms. Smith was listed elsewhere as “VP, Licensing.” Fieldstone SOFA at Ex. 23.

⁸ Mr. Wolfe was listed elsewhere as “VP, Facilities.” Fieldstone SOFA at Ex. 23.

⁹ The only entity listed as holding any stock whatsoever in response to this question was Credit-Based Asset Servicing & Securitization LLC. *Id.*

¹⁰ It should be noted that Fieldstone at one point employed approximately 60 persons with the title Vice President. *See* Fieldstone SOFA at Ex. 22(b).

.” Fieldstone SOFA at 10. The SOFA was signed by Fieldstone President and CEO Michael J. Sonnenfeld.

On February 20, 2008, the bankruptcy court held a hearing on the KERP motion as it applied to these seven employees, in order to determine whether the bonuses requested for them were permissible under the Code. In that hearing, Mr. Sonnenfeld was questioned extensively about the nature of their positions. When asked why persons at Fieldstone were given the title “Vice President,” Mr. Sonnenfeld replied that the title “was an honorarium that was given to people that had to deal on a regular basis with outside counterparties.” Tr. at 70. He continued, though, to say that at least some vice presidents, by virtue of their title, could perform mortgage trades on behalf of the company, *id.*, and that others could sign or issue checks or wire transfers on behalf of the company. *Id.* at 74. He also admitted that the position was created by board appointment. When asked, “All of the seven are officers of the company appointed by the Board, is that correct?” Mr. Sonnenfeld answered “Yes.” Tr. at 116.

With respect to the job responsibilities of these seven employees in particular, Mr. Sonnenfeld said that they were the heads of their respective departments. *Id.* at 76-77. Ms. Bliden was responsible for all of the computing systems at Fieldstone (which was a computer-driven company) and the maintenance of its firewalls. *Id.* at 86. Mr. Brennan, as acting general counsel, reviewed all of the legal documentation generated by and for Fieldstone. *Id.* at 96. He also helped oversee Fieldstone litigation across the country. *Id.* at 98. Mr. Camp’s position required him to protect data involving \$12 million in investments. *Id.* at 85. Ms. Maradie’s position involved paying all vendors and employees of Fieldstone, and generally managing its cash. *Id.* at 89. Ms. McDermott performed all of the reporting requirements for the company,

for instance its statements of financial affairs. *Id.* at 94. Ms. Smith's position involved maintaining Fieldstone's licenses (to buy and sell mortgages) and surety bonds in all 50 states. *Id.* at 90-92. Mr. Wolfe's position involved providing and maintaining equipment for over 90 Fieldstone offices across the country. *Id.* at 79. Since Fieldstone has begun operating in bankruptcy, his position has involved selling Fieldstone's assets across the remaining offices, including negotiating court-approved asset sales. *Id.* at 81. In short, Mr. Sonnenfeld's testimony demonstrated that each of the seven individuals were board-appointed officers who exercised extensive control over various facets of Fieldstone's corporate operations.

At the conclusion of the hearing, the bankruptcy court ruled that bonuses to these seven employees were permissible under the Code because it found them not to be officers under § 101(31)(B)(ii), and therefore not insiders under § 503(c)(1). It offered the following explanation for this ruling:

I think in the decision I'm making, I am applying the law. And what I'm basically saying is that I don't see that . . . the seven individuals that are the subject of this controversy are either officers in the traditional technical sense, nor would they have been considered to be insiders if there was a complaint filed to recover preferences or fraudulent conveyances from any of them.

And the reason for that is even though the definition . . . identifies officers among a list of individuals who are characterized by the Bankruptcy Code definitions as insiders, the Court is not precluded by the terminology that I used from taking evidence from behind the titles that people hold in any given situation. And so I find, first of all, that these vice presidents, despite the title that they enjoy, are holders of honorary titles that have no relationship whatsoever to . . . traditional officers in a corporation

[T]he question is whether they are officers in the traditional sense, in the sense that they are making decisions, they're acting on behalf of the corporation, they are in charge, they are insiders. And I find that none of these seven qualify either as officers or as insiders. And what that means is that 503(c)(1) is not applicable to this situation.

Tr. at 140-41.¹¹ In short, the bankruptcy court, while acknowledging that the seven employees might appear to fit the legal definition of officer (and thus insider) under the Code, found that they did not in fact resemble officers in the “traditional sense,” and so could not be considered insiders.

The court issued an order authorizing Fieldstone to implement its employee incentive plan on February 27, 2008. On February 28, 2008, the U.S. Trustee filed a notice of appeal and an emergency motion for a stay pending appeal. This emergency motion was denied. The U.S. Trustee filed the present appeal on March 20, 2008, contending that the bankruptcy court’s conclusion regarding the seven Fieldstone employees was in error.

ANALYSIS

This court reviews the bankruptcy court’s findings of fact for clear error, *see* Fed. R. Bankr. P. 8013, and its conclusions of law and statutory interpretation de novo. *See In re Off'l Comm. of Unsecured Creditors*, 453 F.3d 225, 231 (4th Cir. 2006); *In re JKJ Chevrolet, Inc.*, 26 F.3d 481, 483 (4th Cir. 1994); *Wolff v. United States*, 372 B.R. 244, 248-49 (D. Md. 2007). To the extent that this appeal concerns the proper interpretations of “officer” and “insider” under § 101(31)(B)(ii), review is de novo. To the extent that it also concerns questions of fact – namely,

¹¹ Section 503(c)(1)(A) provides a separate ground for finding a bonus to an insider to be permissible, namely when the bonus is essential to the retention of an insider who has a bona fide job offer from another business. Mr. Sonnenfeld testified at the hearing that Mr. Brennan had a job offer from another business during the relevant time period, Tr. at 97, however the bankruptcy court did not make any findings of fact regarding this testimony, presumably because it found § 503(c)(1) to be inapplicable. Moreover, no inquiry was made into the job offer’s bona fides or its rate of compensation. Fieldstone does not argue in its appeal brief that Mr. Brennan’s bonus is warranted under § 503(c)(1)(A).

whether under the appropriate legal standard they are officers, based on the fact of their titles, their board appointment, their listings in the SOFA, and their responsibilities – the court applies a hybrid standard, examining the factual portions for clear error and the legal conclusions derived from those facts de novo. *See In re Three Flint Hill*, 213 B.R. 292, 297-98 (D. Md. 1997) (considering “insider” status as a mixed question of law and fact).

The central issue in this appeal is whether the bankruptcy court correctly interpreted the term “officer” for purposes of § 101(31)(B)(ii). While the Bankruptcy Code does not offer a legal definition for “officer,” the term has had wide application in corporate law, and has been defined in other corporate statutes. The Clayton Antitrust Act, for example, defines the term “officer” to mean “an officer elected or chosen by the Board of Directors.” 15 U.S.C. § 19(a)(4). The Model Business Corporation Act (“MBCA”), adopted by the American Bar Association, defines “officer” simply as a position “described in [the corporation’s] bylaws or appointed by the board of directors in accordance with the bylaws.” Model Bus. Corp. Act § 8.40 (2002).¹² Although the Maryland Code does not define “officer” in the corporate context, it does list “elect officers” as one of the duties of corporate directors. Md. Code, Corps. & Ass’ns § 2-109(a)(1). *Accord* Md. Code, Educ. § 16-502(f) (defining the officers of the Baltimore City Community College as “the president and the vice presidents of the College and other officers as shall be

¹² *See also* Black’s Law Dictionary 1117 (8th ed. 2004) (“In corporate law, the term [officer] refers esp. to a person elected or appointed by the board of directors to manage the daily operations of a corporation, such as a CEO, president, secretary, or treasurer.”); *Motions Systems Corp. v. Bush*, 437 F.3d 1356, 1367 (Fed. Cir. 2006) (“The magisterial Oxford English Dictionary defines ‘officer’ as, among other things, ‘a person authoritatively appointed or elected to exercise some function pertaining to public life, or to take part in . . . the management or direction of a public corporation, institution, etc.’”).

appointed by the Board of Trustees”).¹³

As these statutes show, the fact of board appointment or election is frequently identified as distinguishing “officer” positions from other titled positions within a corporation. *See* 2 William Meade Fletcher, *Cyclopedia of the Law of Private Corporations* § 266 (“One distinction between officers and agents of a corporation is the manner of their creation. An office is created by the charter of the corporation, and the officer is appointed or elected by the directors or the shareholders.” (internal footnote omitted)); *see also In re NMI Systems, Inc.*, 179 B.R. 357, 360 (Bankr. D. D.C. 1995) (noting that a corporation’s election of a person to a vice-president position indicates the formal conferring of officer status upon him). As such, when making the threshold determination of whether a titled position fits the legal definition of officer, other features of that position, such as its range of corporate duties and responsibilities, are less relevant.¹⁴ Most relevant is board appointment or election; if that feature is present, as it is here,

¹³ The Delaware Code, often used as a point of reference on corporate law matters, defines “officer” in this way:

“Officer” means[,] [i]f used with respect to a corporation, a person appointed or designated as an officer of such corporation by or pursuant to applicable law or the certificate of incorporation or bylaws of such corporation, or a person who performs with respect to such corporation functions usually performed by an officer of a corporation.

Del. Code Ann. tit. 5, § 3303(14); *see also* Alaska Stat. Ann. § 10.13.990(13) (identical language to the Delaware Code); Minn. Stat. Ann. § 302A.011(18) (““Officer” means a person elected, appointed, or otherwise designated as an officer by the board, and any other person deemed elected as an officer”); Mont. Code Ann. § 32-11-102(15) (nearly identical language to the Delaware Code); Tenn. Code Ann. § 45-8-203(16) (identical language to the Delaware Code).

¹⁴ Indeed, the law does not require an officer to have extensive corporate duties in order to fit the legal definition of “officer.” The MBCA states that an officer’s duties are no more or less than those “set forth in the bylaws or . . . prescribed by the board of directors or by direction of an officer authorized by the board of directors to prescribe the duties of other officers.” Model

the titled position ordinarily is an “officer” position as a matter of law. Insofar as the bankruptcy court understood the definition of “officer” to require additional “traditional” elements, like major decision-making, it expanded the term beyond its ordinary legal meaning.

A related issue in this appeal is whether it was proper for the bankruptcy court to conduct a separate factual inquiry into the authority exercised by the seven employees in order to determine whether they were therefore officers and insiders under the Code. The statute is unambiguous on this matter; if a person is found to be an “officer” as a matter of law, then they are automatically deemed an “insider” as a matter of law as well, and the inquiry ends. Section 101(31)(B) declares that an “insider” includes, among other persons, a “director of the debtor” and an “officer of the debtor” (where the debtor is the now-bankrupt corporation). *See Public Access Technology.com, Inc.*, 307 B.R. 500, 506 (E.D. Va. 2004) (“an officer of the debtor during the relevant period . . . [is] thereby an ‘insider’” under the Code); *In re Babcock Dairy Co. of Ohio, Inc.*, 70 B.R. 662, 666 (Bankr. N.D. Ohio 1986) (stating that, under the Code, “any person that is a director of a corporate debtor . . . is automatically considered to be an insider”). In *Public Access*, the court explained the proper interpretation of the Code’s “insider” provisions as follows:

The Bankruptcy Code defines an “insider” to be, among others, a director of the debtor, an officer of the debtor, or a person in control of the debtor. 11 U.S.C. § 101(31)(B)(i)-(iii). It is unnecessary for a court to determine whether an individual is both a director and a person in control, or both an officer and a person in control, as the statutory definition is clearly stated in the disjunctive. A defendant’s status as

Bus. Corp. Act § 8.41 (2002). Rule 3b-2 of the Securities Exchange Act of 1934 – which defines “officer” to be “a president, vice president, secretary, treasury or principal financial officer, comptroller or principal accounting officer” – states that the duties of an officer are simply “routinely performing corresponding functions with respect to any organization.” 17 C.F.R. § 240.3b-2.

a director or an officer is alone sufficient to establish that he is an insider.

307 B.R. at 505. Thus, the logical reading of the statute is simply that those fitting the legal definition of “officer” are automatically insiders under the Code, regardless of their degree of control over the company.

Because the bankruptcy court viewed the term “officer” as encompassing more than the fact of board appointment or election, its decision to peer “behind the titles” of the seven Fieldstone employees for further evidence of their officer and insider status is understandable.¹⁵ It is true that, “[w]here . . . the defendant’s status as a director or officer is disputed, some inquiry beyond the defendant’s title will ordinarily be required.” *Public Access*, 307 B.R. at 506 n.5. This is precisely what took place in *Public Access* and *NMI Systems*; in both cases, the disputed officers were not elected or appointed by the Board, and so further factual inquiry was justified. *See Public Access*, 307 B.R. at 506; *NMI Systems*, 179 B.R. at 370-71.

¹⁵ Under other circumstances, a factual inquiry would be in keeping with the aims of the Code’s “insider” provisions, which are meant to extend “insider” status to more than just those listed specifically by statute. As one bankruptcy court has explained:

The Code’s use of the word “includes” is intended to denote a general class for which the statute provides a nonexhaustive list of members. As [the Code] makes clear, the terms “include” and “including” are not limiting. . . . An insider may, therefore, be a person or entity other than those enumerated in [the Bankruptcy Code], provided the particular relationship meets these guidelines. In such cases, contemporary insider analysis invites the Court to consider whether the disputed relationship is similar to or bears characteristics of any of the relationships specified in the statute.

In re Gilbert, 104 B.R. 206, 209-210 (Bankr. W.D. Mo. 1989) (internal citations omitted); *see also Butler v. David Shaw*, 72 F.3d 437, 443 (4th Cir. 1996) (“It is well settled that the statutory definition of insider is not exhaustive”); *In re Schuman*, 81 B.R. 583, 586 (9th Cir. Bankr. App. Panel 1987) (“courts have widely agreed that Congress did not intend to limit the classification of insiders to the statutory definition”).

The Code's "person in control" clause offers one way for courts to bring persons titled but not appointed as officers under the heading "insider." 11 U.S.C. § 101(31)(B)(iii). But control, as the court in *Public Access* made clear, is an independent additional ground for finding a person an insider, not a feature that officers or directors are required to possess in order to be deemed insiders. See 11 U.S.C. § 101(31)(B)(iii); see also *In re Cardon Realty Co.*, 146 B.R. 72, 78 (Bankr. W.D.N.Y. 1992) ("It is irrelevant whether [an officer and director] actually 'controlled' [the debtor corporation]"). The Code does not declare that an insider is a "director of the debtor, officer of the debtor, or *other* person in control of the debtor." Nor does it state that an insider is one who is a director or officer of the debtor *and* person in control of the debtor. Simply put, a straightforward application of the statute should render duly appointed or elected officers "insiders," regardless of their degree of "control."¹⁶ See *Public Access*, 307 B.R. at 505 (stating that giving the "insider" portion of the Code a different meaning would "do violence to the plain meaning of the statute").

In this case, the undisputed fact that these seven persons all had been appointed as

¹⁶ Indeed, as the U.S. Trustee argued in this case, to read the statute differently would lead to absurd results. See *Aremu v. Dep't of Homeland Sec.*, 450 F.3d 578, 583 (4th Cir. 2006) (noting "the settled rule that a court must, if possible, interpret statutes to avoid absurd results"). For one, if an officer or director were required to be a "person in control" as well, the officer and director clauses would be superfluous. Also, if an officer or director were required to be a "person in control" as well, why would she not be additionally required to be a "relative" under § 101(31)(B)(vi)? Finally, if the court were to accept Fieldstone's assertion that the terms "officer" and "director" are meant to capture persons "in control," what does this mean for the "relatives" provision, since relatives are frequently not persons in control and yet insiders? See, e.g., *Matter of Hunt*, 154 B.R. 1016, 1021 (Bankr. M.D. Ga. 1993) (husband of debtor's niece found to be an "insider" as a matter of law simply because he was a relative of the debtor); *In re Trans Air, Inc.*, 78 B.R. 351, 352-54 (Bankr. S.D. Fla. 1987) (wife of businessman found to be "insider" as a matter of law, even though she had no role in the day-to-day affairs of her husband's business).

officers by the Board should have been sufficient to establish their officer status as a matter of legal interpretation.¹⁷ Section 503(c)(1) therefore applies to prevent the seven Fieldstone officers from receiving bonuses as part of an employee incentive plan.

CONCLUSION

For the foregoing reasons, the bankruptcy court's ruling must be reversed. A separate Order follows.

November 5, 2008
Date

/s/
Catherine C. Blake
United States District Judge

¹⁷ Even if board appointment were held insufficient, however, the bankruptcy court's factual conclusion that the seven were not officers would be clearly erroneous in light of the combined facts of title, board appointment, job responsibilities, and identification as officers and insiders in the company's filings.

Signed: February 26, 2008

SO ORDERED

For reasons stated on the record at the hearing.



James F. Schneider

JAMES F. SCHNEIDER

U. S. BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(Baltimore Division)**

In re:

*

**FIELDSTONE MORTGAGE
COMPANY,**

*

Case No. 07-21814-JS
(Chapter 11)

*

Debtor.

* * * * *

**ORDER AUTHORIZING DEBTOR TO IMPLEMENT
EMPLOYEE INCENTIVE PLAN**

Upon consideration of the Motion for Order Authorizing Debtor to Implement Employee Incentive Plan Pursuant to Sections 105, 363 and 503 of the Bankruptcy Code (the "Motion"), and the objection of the Office of the United States Trustee and the limited objection Official Committee of Unsecured Creditors, and the Court having previously entered a final Order Authorizing Retention Payments on February 8, 2008 [Docket No. 196] (the "Retention Order"), and the Retention Order having granted the relief requested in the Motion as to certain employees, and the Court having conducted a hearing on the Motion on February 20, 2008 to consider the remaining relief requested in the Motion as to the employees holding the position of "Non-Executive Officers" on *Exhibit A* attached hereto, and at said hearing, the Court having considered the evidence presented and the arguments of counsel, and at the conclusion of said hearing the Court

having issued its findings of fact and conclusions and law, which findings of fact and conclusions of law are incorporated herein by reference, it is therefore by the United States Bankruptcy Court for the District of Maryland,

ORDERED that the objection of the Office of the United States Trustee and the limited objection of the Official Committee of Unsecured Creditors to the Motion are overruled; and it is further

ORDERED that the Motion with respect to the employees designated as “Non-Executive Officers” on *Exhibit A* attached hereto is hereby GRANTED; and it is further

ORDERED that the Debtor is authorized to implement the employee incentive plan as set forth in the Motion, and make the payments set forth in the Motion to each of the seven (7) “Non-Executive Officers” listed on *Exhibit A*, subject to the availability of funds as set forth in the Motion.

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END OF ORDER

EXHIBIT A

Retention Payment Schedule

Fieldstone Mortgage Company

Exhibit A

Retention Payment Schedule

2/5/2008
11:21 AM

| LFull Name | Title and Role | Proposed End Date | Payable 1/15/2008 | Payable 1/31/2008 | Remainder no later than 2/28/08 | Total Retention |
|-------------------------------|-----------------------------------|----------------------|----------------------|----------------------|--|--------------------|
| Staff Positions | | | | | | |
| Kinsey, Andrew B. | Team Lead, Systems | 12/31/2007 | 12,017 | | | 12,017 |
| Crawford, John L. | Ass't VP Network & System Admin. | 12/31/2007 | 14,875 | | | 14,875 |
| Clyburn, Afetha L. | Ass't VP Final Documents | 12/31/2007 | 9,625 | | | 9,625 |
| Peele, Lunette | Senior Specialist Collateral | 12/31/2007 | 5,785 | | | 5,785 |
| Gustavson, Karen R. | Ass't VP, Ass't Gen Counsel | 1/15/2008 | 25,688 | | | 25,688 |
| Beadenkopf, Kathleen A. | Facilities Manager | 2/28/2008 | 12,437 | 12,437 | 12,437 | 37,312 |
| McCarthy, Diane | Senior Paralegal | 2/28/2008 | 11,160 | 11,160 | 11,160 | 33,480 |
| Castle, Stephen T. | File Room Manager | 2/28/2008 | 5,700 | 5,700 | 5,700 | 17,101 |
| Widmer, Robert F. | Ass't VP Software Development | 2/28/2008 | 22,750 | 22,750 | 22,750 | 68,250 |
| Caniglia, Michael A. | Manager Help Desk | 2/28/2008 | 12,000 | 12,000 | 12,000 | 36,000 |
| Culp, James B. | Ass't VP Client Services | 2/28/2008 | 13,780 | 13,780 | 13,780 | 41,340 |
| Lewis, Cherrel A. | Manager Payroll | 2/28/2008 | 12,667 | 12,667 | 12,667 | 38,000 |
| Heigh, Brenda L. | Supervisor, Accounts Payable | 2/28/2008 | 9,241 | 9,241 | 9,241 | 27,723 |
| Boule, Patricia A. | Senior Analyst, Systems | 2/28/2008 | 11,667 | 11,667 | 11,667 | 35,000 |
| | | | 179,391 | 111,402 | 111,402 | 402,194 |
| Non-Executive Officers | | | | | | |
| Brennan, Thomas S. | VP Ass't Gen. Counsel, Ass't Sec. | 1/31/2008 | 30,000 | 30,000 | | 60,000 |
| Maradie, Nancy J. | VP, Ass't Treasurer | 2/28/2008 | 13,783 | 13,783 | 13,783 | 41,350 |
| Bliden, Jennifer L. | VP Systems | 2/28/2008 | 14,438 | 14,438 | 14,438 | 43,313 |
| Camp, John C. | SVP & Chief Information Officer | 2/28/2008 | 33,333 | 33,333 | 33,333 | 99,999 |
| Smith, Jacqui | VP Licensing | 2/28/2008 | 15,000 | 15,000 | 15,000 | 45,000 |
| Wolfe, William L. | VP Facilities | 2/28/2008 | 16,583 | 16,583 | 16,583 | 49,750 |
| McDermott, Teresa A. | SVP & Controller | 2/28/2008 | 30,667 | 30,667 | 30,667 | 92,000 |
| | | | 153,804 | 153,804 | 123,804 | 431,412 |