

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

40-7560

In re:) Chapter 11)
)
FANSTEEL INC., et al.,¹) Case No. 02-10109 (JJF)
) (Jointly Administered))
)
Debtors.)

Objection Deadline: November 26, 2002 at 4:00 p.m.E.T.
Hearing Date: TBD, Only if objections are timely filed

**NOTICE OF MOTION FOR ORDER APPROVING
DEBTORS' EMPLOYEE RETENTION AND INCENTIVE
PROGRAM FOR KEY EMPLOYEES UNDER 11 U.S.C. § 105(a) AND 363(b)**

TO: OFFICE OF THE UNITED STATES TRUSTEE; COUNSEL FOR THE
OFFICIAL COMMITTEE OF UNSECURED CREDITORS; ALL THOSE
PARTIES WHO HAVE REQUESTED NOTICE PURSUANT TO RULE 2002
OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE.

The captioned debtors and debtors in possession (collectively, "Debtors") filed the attached "*Motion for Order Approving Debtors' Employee Retention and Incentive Program for Key Employees Under 11 U.S.A. § 105(a) and 363(b)*" (the "Motion") with the United States Bankruptcy Court for the District of Delaware, 824 Market Street, Wilmington, DE 19801 (the "Bankruptcy Court"). The Motion seeks entry of an order approving Debtors' retention and incentive program with respect to certain of its key employees under 11 U.S.C. § 105(a) and 363(b). Objections and responses to the Motion, if any, must be in writing and filed with the Bankruptcy Court no later than 4:00 p.m. on November 12, 2002. At the same time, you must also serve a copy of the objection or response on the undersigned Debtors' counsel.

¹The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc., Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., American Sintered Technologies, Inc., and Fansteel Schulz Products, Inc.

Nm5501 Add: RidsDgcMailCenter

IF YOU FAIL TO RESPOND OR OBJECT IN ACCORDANCE WITH THIS NOTICE, THE COURT MAY GRANT THE RELIEF REQUESTED IN THE APPLICATION WITHOUT FURTHER NOTICE OR HEARING.

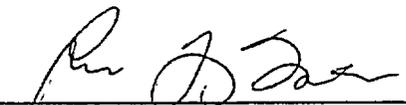
A HEARING ON THE MOTION WILL BE HELD AT THE COURT'S CONVENIENCE ONLY IF OBJECTIONS OR RESPONSES ARE TIMELY FILED.

Dated: November 7, 2002

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Co-Counsel for the Debtors and Debtors in Possession

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:) Chapter 11
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FANSTEEL INC., et al.,¹) Case No. 02-10109 (JJF)
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**MOTION FOR ORDER APPROVING DEBTORS' EMPLOYEE
RETENTION AND INCENTIVE PROGRAM FOR KEY EMPLOYEES
UNDER 11 U.S.C. §§ 105(a) AND 363(b)**

The debtors and debtors in possession in the above-captioned case (the "Debtors") hereby move ("Motion") the Court for entry of an order approving the Debtors' retention and incentive program with respect to certain of its key employees (the "Key Employees") under 11 U.S.C. §§ 105(a) and 363(b). In support of this Motion, the Debtors respectfully represent as follows:

Jurisdiction

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

2. The statutory basis for the relief requested herein is 11 U.S.C. §§ 105(a) and 363(b).

¹The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc., Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., American Sintered Technologies, Inc., and Fansteel Schulz Products, Inc.

Background

3. On January 15, 2002 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in any of the Debtors' chapter 11 cases ("Cases"). On January 29, 2002, the Office of the United States Trustee for the District of Delaware appointed an official committee of unsecured creditors (the "Committee") for the Cases.

4. Although the Debtors filed their petitions for relief on January 15, 2002, they were unable to obtain DIP financing until May 2002 because potential DIP lenders were concerned that the rights of the NRC would prime their rights.² Congress Financial Corporation ("Congress") ultimately entered into a DIP Facility with the Debtors under which the Debtors are jointly and severally liable. Currently, there are no drawings under the DIP Facility nor do the Debtors expect to draw any amounts prior to the end of year 2002.

5. On August 19, 2002, this Court entered an order authorizing the employment and retention of Executive Sounding Board Associates Inc. ("ESBA") as the Debtors' restructuring consultant and financial advisors. Pursuant to the terms of the ESBA retention, ESBA assisted the Debtors in the preparation of the proposed retention and service program for which this Motion seeks approval.

6. The Debtors and ESBA are currently completing the first of two phases in a business plan; that is, review of the qualitative analysis of the business of the operational side of

²For example, such concerns specifically were expressed by Foothill Capital Corporation and The CIT Group/Business Credit, Inc., which refused to lend without the affirmative consent of the NRC.

the business, examining strengths, weaknesses, opportunities and threats; examining trends in business, developing business strategies and objectives, and developing a marketing plan.

7. The Debtors also have embarked on the second phase of the business plan – a multi-year extended budget reflecting specific strategies and tactics to be employed in a successful reorganization. From this multi-year budget, the derivative cash flow necessary to fund a plan will become apparent. The Debtors anticipate completing the multi-year business plan for the operational side of the Debtors' business by late November 2002.

8. In addition, the Debtors will soon file a motion seeking to expand the scope of ESBA's retention to include assistance in the preparation of going concern and liquidation analyses. It is anticipated that such preliminary analyses will be completed by early December 2002.

9. The Debtors and the Committee have scheduled a series of meetings on December 4 and 5, 2002 to discuss the proposed business plan, the valuation analyses and various structures for a plan of reorganization. As discussed below, retention of the Debtors' Key Employees is critical to implementation of a business plan, and to maintain and maximize the value of each of the Debtors.

Relief Sought By The Debtors

10. The Debtors seek Court approval of the retention plan and incentive program described in this Motion. The proposed retention plan and severance program is further described in Exhibit A attached to the Motion (the "Retention Program"). The Retention Program covers 25 Key Employees.

11. The Retention Program is designed to induce Key Employees to remain with the company through plan confirmation or sale of their business unit, or a combination thereof,

and thereby provide a continuity of management and assistance in achieving the ultimate goal of maximizing the value of the Debtors' estates.

12. An integral part of the Debtors' reorganization process is the stabilization and motivation of its Key Employees. There is a significant risk that the Key Employees, concerned about the consequences of the bankruptcy filings, will (or have) initiated searches for alternative employment opportunities without approval of this Retention Program. With the passage of time, solicitation of Key Employees has intensified and the Debtors are aware that certain Key Employees have received hard offers from competing companies. Although there have been few losses of key personnel since the bankruptcy filing, key management has been aware that the company would be developing a retention plan once DIP financing was secured and a business plan developed (with the significant assistance and input of the Key Employees) this knowledge has helped to retain Key Employees to this point. All of the Debtors' businesses are thinly staffed and the loss of any Key Employee from any of these business segments represents a significant problem for the Debtors, because generally, there are no internal candidates to replace general managers, financial managers, controllers, manufacturing managers or sales managers. The Key Employees are intimately familiar with the Debtors' businesses and are essential to the continuity of operations and leadership during the uncertainty of the reorganization process. Moreover, the market value of the Debtors' businesses will be severely impacted if the Debtors were to lose Key Employees at this critical juncture in the reorganization process.

13. Further, the Debtors cannot afford the time or the expenses associated with educating new hires for key positions. If the Debtors are unable to maintain and provide incentives for these Key Employees, the Debtors could not only lose their most valuable

resource, but could also lose their opportunity to successfully reorganize. Accordingly, the Debtors seek approval of this Retention Program.

14. The Debtors' existing incentive programs, including stock options ("Stock Options") and a long-term incentive plan based on economic valued added principles (the "EVA Program"), are currently ineffective given the Debtors' economic condition. Existing Stock Options are presently worthless and it is unlikely that these options will have any value at the conclusion of these Cases. While the EVA Program does represent a method for focusing management's attention on improving the value of the businesses through incentives based upon improving operating profits and asset management, the Debtors' financial difficulties starting in the second half of 2001 relating to recognition of environmental liabilities, the subsequent loss of its revolving line of credit and general economic downturn, required that the Debtors take actions that reduced profitability in the short term, such as discounting of receivables, recording additional provisions for bad debts and environmental liabilities, and write-offs of inventory. As a consequence of the Debtors' actions taken in the second half of 2001, only four of the Key Employees' accounts (derived from the EVA Program) have a positive balance. While the Debtors plan to continue the EVA Program during 2002, it is unlikely that this program, by itself, would provide a sufficient incentive to retain Key Employees due to continued financial difficulties with the significant costs of bankruptcy inhibiting attainment of positive EVA balances. Accordingly, the Debtors propose that the EVA Program be supplemented by the Retention Program proposed herein.

The Retention Program

15. The Retention Program incorporates a stay bonus ("Stay Bonus") and a severance payment ("Severance Payment") component as described below.

16. Each Key Employee will receive a stay bonus ("Stay Bonus") if they are employed by any of the Debtors on the payment dates as follows: (a) on December 31, 2002, December 31, 2003 and on the confirmation date, each Key Employee shall receive a portion of the Stay Bonus described in Exhibit A. The total amount of the Stay Bonus is based upon a percentage of that Key Employee's annual salary as described in Exhibit A. Any Key Employee who leaves the company prior to a payment date will receive no payment beyond what has already been paid to that particular Key Employee.

17. If any business unit (or substantially all of the assets constituting same) of the Debtors is sold during the pendency of these Cases, the Key Employees of that business unit shall receive, upon closing of such sale, 100% of the Stay Bonus payable less any amounts already paid as part of the Stay Bonus.

18. In addition to the Stay Bonus, the Retention Program provides that Key Employees may be entitled to a Severance Payment as discussed in paragraph 19 below.

19. For the Debtors' Chief Executive Officer (the "CEO"), termination without Cause³ or constructive termination will trigger a payment of 150% of annual base salary (over and above any amounts already paid as part of the Stay Bonus) and continuation of all employee benefits for 18 months from the date of termination. For the Chief Financial Officer (the "CFO"), termination without Cause or constructive termination will trigger a payment of 100% of base salary (over and above any amounts already paid as part of the Stay Bonus) and continuation of all employee benefits for 12 months from the date of termination. For General Managers, termination without Cause during the pendency of the bankruptcy cases will trigger a payment of 50% of base salary (over and above any amounts already paid as part of the Stay

³ The term "Cause" as applied to the CEO and CFO is limited to instances of fraud, gross negligence or conviction of a crime during the pendency of these Cases. For all other Key Employees, the term "Cause" shall mean grounds for dismissal applying reasonable industry standards.

Bonus) and continuation of all employee benefits for 6 months from date of termination. For all other Key Employees, termination without Cause during the pendency of these Cases will trigger the payout of 100% of the Stay Bonus, (less amounts already paid as part of the Stay Bonus) as well as continuation of all employee benefits for 3 months from the date of termination.

20. The Stay Bonus is designed to cover 25 Key Employees (2.0% of the Debtors total work force) at a total payout not to exceed \$1,606,000 (1.2% of 2001 total revenue).

21. In sum, the Debtors believe the continued and uninterrupted services of each of the Key Executives during the pendency of these Cases is essential to the success of, and will help to maximize the recovery of, the Debtors' creditors in such proceeding.

Argument and Authorities

A. The Retention Program Should be Approved Under Bankruptcy Code Section 363(b)(1)

22. Pursuant to Bankruptcy Code sections 363(b) and 105(a), the Debtors request an order approving and authorizing the implementation of the proposed Retention Program. Arguably, the implementation of the Retention Program requires Court approval because it represents a proposed use of the Debtors' property outside the ordinary course of their business. Bankruptcy Code § 363(b)(1) provides, in pertinent part:

[t]he 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). See In re Buyer's Club Markets, Inc., 5 F.3d 455, 458 (10th Cir. 1993) (debtor's severance plan adopted postpetition that was triggered only in the event that the Chapter 11 case converted to Chapter 7 which was a transaction out of the ordinary course of business and required notice and hearing); In re Media Central, Inc., 115 B.R. 119, 126 (Bankr. E.D. Tenn. 1990) (postpetition severance pay agreement with management team employees was

a transaction out of the ordinary course of business and required notice and hearing); In re Century Brass Prods., Inc., 107 B.R. 8, 11 (Banks. D. Conn. 1989) (same).

23. The proposed use, sale, or lease of property of the estate may be approved under Bankruptcy Code § 363(b) if it is supported by the sound business judgment of the Debtors' management. See In re Delaware & Hudson Ry. Co., 124 B.R. 169, 1796 (D. Del. 1991). Although established in the context of a proposed sale, the "business judgment" standard has been applied in non-sale situations. See, e.g., The Dai-Ichi Kangyo Bank, Ltd., Chicago Branch v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.), 242 B.R. 147, 153 (D. Del. 1999) (Court applied 'business judgment' standard in context of an employee incentive program under 11 U.S.C. § 363(b)); Institutional Creditors of Continental Air Lines v. Continental Air Lines (In re Continental Air Lines), 780 F.2d 1223, 1226 (5th Cir. 1986) (court applied 'business judgment' standard in context of proposed 'use' of estate property). The business judgment standard is the appropriate test for considering the approval of employee retention plans in the context of a bankruptcy case. See, e.g., In re Montgomery Ward Holding Corp., 242 B.R. at 153; In re American West Airlines, Inc., 171 B.R. 674 (Banks. D. Ariz. 1994); In re Interco, Inc., 128 B.R. 229 (Banks. E.D. Mo. 1991).

24. In determining whether to authorize the use, sale or lease of property of the estate under § 363(b), courts require the debtor to show a sound business purpose that justifies such actions. In re Montgomery Ward Holding Corp., 242 B.R. 153; In re Delaware & Hudson Ry. Co., 124 B.R. at 176; In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983). In In re Interco and American West Airlines, both of which dealt with employee retention programs, the courts concluded that the debtor is not required to demonstrate a reasonable probability of successful reorganization. Instead, both cases acknowledge that the determination of whether to

approve such programs turns on the facts and circumstances of each particular case. In re Interco, 128 B.R. at 233; American West Airlines, 171 B.R. at 678. For example, In American West Airlines, the court approved bonuses to certain officers and employees three years after the petition date based upon the "the hard work and dedication of all the employees."⁴ Id.

25. The debtor carries the burden of demonstrating that the particular use, sale or lease will assist the debtor's reorganization; however, a party objecting is required to produce evidence that supports their objections. In re Delaware & Hudson Ry. Co., 124 B.R. at 176; In re Lionel Corp., 722 F.2d at 1071. See also In re Montgomery Ward Holding Corp., 242 B.R. at 155 (Farnan, C.J.) (affirming employee incentive plan; Debtors presented ample evidence that sound business purpose justified Debtors' employee incentive program through testimony of Debtors' Executive Vice President of Human Resources and by Ernst & Young, compensation consultant of Debtors; creditor, Bank Group, failed to produce any evidence at the hearing to controvert testimony of the Debtors' witnesses).

26. The Retention Program is amply supported by the Debtors' sound business judgment. The Retention Program is a critical component to the success of the Debtors' continuing efforts to maintain and enhance the value of their assets in order to reorganize or maximize such value through a sale of one or more business units, or a combination thereof. The Retention Program is designed to keep critical full-time employees working for the Debtors during the sale/reorganization process. The Key Employees need to be given an incentive to remain with the Debtors during these unpredictable and volatile times. These Key Employees are fully aware that, any large bankruptcy reorganization scenario creates a risk of job elimination. Without the proposed economic incentives, Key Employees may leave, causing

⁴ Under this particular plan, 28 officers and managers received cash bonuses totaling \$1,170,706; the COO received a \$400,000 cash bonus; the rank and file employees received bonuses totaling \$9,500,000; and the CEO received 125,000 shares of common stock.

remaining Key Employees to face additional burdens of operating the Debtors' facilities with a further reduced workforce.

B. The Retention Program Should be Approved Under Section 105(a) of the Bankruptcy Code

27. Although the Court may properly authorize the Debtors' request under Bankruptcy Code § 363(b)(1), the Court may also approve the Retention Program pursuant to Bankruptcy Code § 105(a). That section provides in pertinent part that "the Court may 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 this section, the Court has expansive equitable powers to fashion any order or decree which is in the interest of preserving or protecting the value of the debtor's assets. See, e.g., In re Chinichian, 784 F.2d 1440, 1443 (9th Cir. 1986) ("Section 105 sets out the power of bankruptcy court to fashion orders as necessary pursuant to the purposes of the Bankruptcy Code."); Bird v. Crown Convenience (In re NWFEX, Inc.), 864 F.2d 588, 590 (8th Cir. 1988) ("The overriding consideration in bankruptcy . . . is that equitable principles govern."); In re Cooper Properties Liquidating Trust, Inc., 61 B.R. 531, 537 (Bankr. W.D. Tenn. 1986) ("Bankruptcy Court is one of equity and as such it has a duty to protect whatever equities a debtor may have in property for the benefit of their creditors as long as that protection is implemented in a manner consistent with the bankruptcy laws.").

Conclusion

28. Approval of the Retention Program is critical to the Debtors' reorganization efforts. Accordingly, it is in the best interest of the estates that the Court authorize and approve the Retention Program.

Notice

29. Notice of this Motion will be provided to (a) the Office of the United States Trustee; (b) counsel to the Official Committee of Unsecured Creditors; and (c) all parties who have requested notice pursuant to Rule 2002 of the Federal Rules of Bankruptcy Procedure. In light of the nature of the relief requested, the Debtors submit that no further notice should be required.

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto, (i) approving and authorizing the Retention Program with the Key Executives; (ii) authorizing the Debtors to make the payments thereunder without further order of the Court; (iii) allowing Key Executive claims under the Retention Program as

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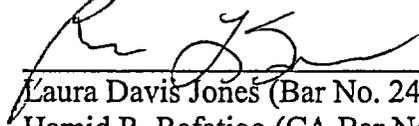
allowed administrative expense claims pursuant to sections 503(b)(1) and 507(a)(1) of the
Bankruptcy Code; and (iv) granting such other and further relief as is necessary and proper.

Dated: November 7, 2002

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Counsel for Fansteel Inc., et al.
Debtors and Debtors In Possession

Exhibit A

Stay Bonus

Employees in the Debtors' businesses and subsidiaries who are covered by the Stay Bonus are the CEO, CFO, General Managers and key direct reports.

Payments under the Stay Bonus will be made as follows:

Fansteel CEO – 100% of annual base pay to be paid when a plan of reorganization is confirmed.

Fansteel CFO – 100% of annual base pay to be paid as follows:

20% of annual base pay to be paid December 31, 2002

30% of annual base pay to be paid December 31, 2003 or when a plan of reorganization is confirmed, whichever is earlier

50% of annual base pay to be paid when a plan of reorganization is confirmed.

General Manager – 50% of annual base pay to be paid as follows:

10% of annual base pay to be paid December 31, 2002

15% of annual base pay to be paid December 31, 2003 or when a plan of reorganization is confirmed, whichever is earlier

25% of annual base pay to be paid when a plan of reorganization is confirmed.

Key direct reports of General Managers – 30% of annual base pay to be paid as follows:

5% of annual base pay to be paid December 31, 2002

10% of annual base pay to be paid December 31, 2003 or when a plan of reorganization is confirmed, whichever is earlier

15% of annual base pay to be paid when a plan of reorganization is confirmed.

Director of Tax & Audit, Environmental Director, and Corporate Accounting Manager – 35% of annual base pay to be paid as follows:

5% of annual base pay to be paid December 31, 2002

10% of annual base pay to be paid December 31, 2003 or when a plan of reorganization is confirmed, whichever is earlier

20% of annual base pay to be paid when a plan of reorganization is confirmed.

The Retention Program is designed to cover 25 key employees (2.0% of the total work force) at a total payout not to exceed \$1,606,000 (1.2% of 2001 total revenue).

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**ORDER APPROVING DEBTORS' EMPLOYEE RETENTION
AND INCENTIVE PROGRAM FOR KEY EMPLOYEES
UNDER 11 U.S.C. §§ 105(a) AND 363(b)**

Upon the motion (the "Motion") of the debtors and debtors in possession in the above-captioned chapter 11 case (the "Debtors"), seeking entry of an order approving Debtors' retention and incentive program for Key Employees under 11 U.S.C. §§ 105(a) and 363(b); and it appearing that the relief requested is in the best interests of the Debtors' estates, their creditors and other parties in interest; and notice of the Motion having been given to the Office of the United States Trustee, counsel to the Committee and those parties required to receive notice pursuant to Delaware Local Rule of Bankruptcy 2002-1(b); and after due deliberation and cause appearing therefore:

IT IS HEREBY ORDERED that:

1. The Motion is granted in its entirety.
2. The Debtors are authorized to enter into the Retention Program² for the

Key Employees as described in the Motion.

¹ The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc., Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., American Sintered Technologies, Inc., and Fansteel Schulz Products, Inc.

² Defined terms shall have the meanings ascribed to them in the Motion.

3. The Debtors are authorized to make payments under the Retention Program without further order of the Court.

4. Key Executive claims under the Retention Program shall constitute allowed administrative expense claims pursuant to sections 503(b)(1) and 507(a)(1) of the Bankruptcy Code.

5. This Court shall retain jurisdiction to hear and determine all matters arising from the implementation of this order.

Dated: November ____, 2002

The Honorable Joseph J. Farnan, Jr.
United States District Court Judge